In the

Supreme Court of the United States

October Term, 1978

No. ——

78-463

Chestnutt Management Corporation,

Petitioner,

v.

Eleanor C. Miller,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Clendon H. Lee
Counsel for Petitioner
Chestnutt Managament Corporation
One Dag Hammarskjold Plaza
New York, New York 10017
Tel. (212) 754-1430

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CHESTNUTT MANAGEMENT CORPORATION* (a Connecticut Corporation) seeks a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Second Circuit entered April 3, 1978.

Opinions Below

The judgment is not reported (A19).** The statement by Judge Timbers rendered from the bench is not

* Petitioner, its parent Chestnutt Corporation and George A. Chestnutt, Jr., its president, are generally called "Chestnutt" herein.

** "A——" refers to appendix hereto. "——a" refers to appendix below.

reported and is printed A23. The panel affirmed the judgment on a jury verdict rendered in one hour and ten minutes following a three day trial upon which judgment was entered October 21, 1975 awarding Respondent Eleanor Miller*** exactly $53,000 against investment adviser Chestnutt. Senior Judge Murphy had denied motions to dismiss at the end of plaintiff's case and the entire case and refused defendants' charges (printed A8 hereto). His charge is printed A11. On September 20, 1977 Judge Murphy denied Chestnutt's Motion for Judgment Notwithstanding the Verdict, or alternatively, for new trial.

Jurisdiction

This Court's jurisdiction is invoked pursuant to 28 U.S.C. §1254 (1). The entry of the Court of Appeals judgment was April 3, 1978, and a timely Petition for Rehearing with Suggestion for Rehearing En Banc was denied June 22, 1978.

Questions Presented

1. Whether financial writing published to the world is free speech, or whether the First Amendment permits money damage under a criminal statute*

—Where, the only attempt to allege or prove the "circumstances constituting fraud . . . with particularity" required by Rule 9(b), F.R. Civ. Pr., consisted of:

a. the 17th Edition of a 20-year old book, filed annually with the SEC,

*** Her husband Dudley acted for her throughout and they are generally called "Miller" herein.

* Investment Advisers Act of 1940, Sec. 217; 15 U.S.C. 80b-17.

b. a magazine article by an independent third party in a professional journal,

c. about 75 weekly, two-page opinion letters by Chestnutt accompanied by four pages of unchallenged facts filed weekly with the SEC,

d. a "D minus" grade conferred by *Forbes Magazine* upon a different investment advisory client of Chestnutt,

with all of which views and opinions an "expert" stockbroker formerly employed by *Forbes Magazine*, over objection, disagreed;

—and—

—Where, there was neither allegation nor proof of misstatement or omission of any historical fact, either material or immaterial;

—and—

—Where, no security or transaction was alleged, or even identified, to involve fraud under federal or state law;

—and—

the gravamen of the complaint was failure to order "short sales" by Miller's independent third party broker contrary to Chestnutt's published views that stock prices were more likely to advance than decline, which advances occurred promptly after Miller ordered an account liquidated.

Necessarily embraced in the foregoing is the denial of Fifth Amendment due process for vagueness (***Winters*** v. *New York,* 333 U.S. 507 (1948) and ***First National Bank,*** *etc.* v. ***Bellotti,*** —— U.S. —— (1978)) and the substitution of presumption for proof and causation (***Tot*** v. ***United States,*** 319 U.S. 463 (1943) and ***Thompson*** v. ***Louisville,*** 362 U.S. 199 (1960)).

2. May a private right of action for damages be implied under the Investment Advisers Act of 1940,* under which statute (and Regulations) this is believed to be the first final* judgment awarding damages.

Constitutional and Statutory Provisions Involved

This case invokes freedom of speech and press under the First Amendment and the Due Process Clause under the Fifth Amendment to the Constitution of the United States. Also involved are Sections 206, 214 and 217 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-6, 14 and 17) and Reg. §275.206(4)-1 thereunder, printed in the Appendix (A26-30).

Statement of the Case

Introduction

This case indicted a book published in 1952 (17th Ed., copyright 1969 with factual tabulations through 1968, in evidence to the jury in 1975 as Ex. 5) and punished the author. Not only its quarter-century old cartoons, but also a ten-column copyrighted magazine article written in *Medical Economics* (Ex. 4) by its Senior Editor, constituted federal securities "fraud", as did some 75 weekly letters of opinion published worldwide (Ex. 3).

* Justices Stewart and Powell would have granted certiorari on the pleadings in *Fleschner* v. *Abrahamson* (No. 77-1279, *cert. den.* May 15, 1978). For the reasons stated in that petition, and by Judge Gurfein dissenting therein below (568 F.2d at 879), and by Judge Hill, dissenting in *Wilson* v. *First Houston Inv. Corp.*, 5 Cir. 1978, 566 F.2d 1235, 1243 (*pet.* pending, *First Houston Investment Corp.* v. *Wilson* (No. 77-1717)) the petition herein should be granted.

This unconstitutional consequence was upon the causal *nexus* that *Forbes Magazine* opined a "D minus" grade to a different Chestnutt advisory client American Investors Fund, Inc. which in a couple of decades of operations has appreciated in value about 3½ times the Dow-Jones Industrial average, or plus 339% vs. plus 101%.

The courts below drummed published financial opinion out of the First Amendment mansion in the following manner.

Petitioner Chestnutt believed and wrote that the savage stock market *débacle* in spring 1970 was overdone, and he published weekly—worldwide—the word "bullish" * and his opinion that prices were more likely to advance than decline. Respondent Miller saw a headline in Paris, ordered an account maintained with a third party broker (Spencer Trask & Co.) liquidated, and sued for federal statutory and Connecticut fraud for Chestnutt's failure to order "short sales" in Miller's account.

No historical fact published by Chestnutt was challenged. There was no claim of omission of any historical fact or failure to keep Miller currently and exactly informed of the account. No security or transaction was alleged or even identified as involving "fraud", federal or state.

Miller's counsel summed up to the jury as to Chestnutt's opinion:

> "The only information that he had as to the *future* of the market is right here in Exhibit 3. The only *prognostications* made that were available to Mr. Miller were right here. . ." (456a, emphasis added).

* The decisions below permit a jury to make criminal and subject to incalculable liability the television picture of a "Thundering Herd" and the statement "Merrill Lynch is Bullish on America". See *Winters* v. *New York*, 333 U.S. 507 (1948).

Over no less than nine objections (22a, 23a, 27a, 38a, 39a, 50a, 51a, 52a, 54a-56a), one Quick,* who became a stock broker after the events complained of, opined the market trend was "bearish" for the five months from November 26, 1969 through April 1970. (188a-198a).

The judge, among other things, compelled the jury on the basis of expert testimony to find an orthodox dogma of financial opinion as to future stock prices, charging:

> ". . . a Wall Street broker who has by reason of education and experience become expert in his profession or trade or business may be permitted to state his opinion as to a matter in which he is versed and which is material to the case. He also may state the reasons for his opinion.
>
> You *should* consider the opinion of the two[*] experts that we had. You can reject the expert's opinion entirely if you conclude that the reasons given in support of the opinion are unsound." (A15, Emphasis added).

Shortly after Miller's panic liquidation, stock prices moved sharply higher, reaching all time highs by January 1973.

A six-person jury after a three day trial and in an hour and ten minutes on Friday afternoon awarded exactly $53,000. Judge Timbers dictated affirmance from the bench (A23).

The 65-paragraph complaint (denied generally) alleges weekly publication of "Stock Market Survey" Reports and management of American Investors Fund, Inc. (¶2). (7a, ff.)

* Employed by *Forbes Magazine* in 1969 and 1970.

* The judge apparently treated George Chestnutt, who has never been affiliated with a broker or dealer, as the second "expert".

¶28 alleged:

> "28. On various and divers occasions from February 16, 1969 to April 24, 1970, defendants, or one of them, made to plaintiff *through their various publications* several statements which were false and misleading about the *state of the securities market in the United States* and which, on information and belief, were known to defendants to be false and misleading, or, in the alternative, should have been known to defendants to be false and misleading." (Emphasis added).

The virtues of "short sales" were extolled in ¶'s 8, 50(d), 63, and ¶64 reads:

> "64. Market conditions, on many occasions during the period February 16, 1969, to April 24, 1970 *dictated the employment of the 'short sale'*. Defendants, recklessly and with apparent disregard for the financial interests of plaintiff, failed to 'sell short' for plaintiff's account." (Emphasis added).

The four purported causes of action went to the jury as a claim under Section 206 of the Investment Advisers Act and a claim for Connecticut common law fraud.

Further Statement and Chronology

About 1952 George A. Chestnutt, Jr. published:

"STOCK MARKET ANALYSIS
Facts and Principals"

which (as well as subsequent editions) was filed with the Securities and Exchange Commission, its 17th Edition, called the "Redbook" in the record, copyright 1969 by Chestnutt Corporation, is Ex. 5 (577a, ff.).

Philip Harsham, Senior Editor, *Medical Economics*, wrote a ten-column article entitled "Profiting from Stock Market Psychology" in that professional magazine (copyright 1968 by Medical Economics, Inc., a subsidiary of Chapman-Reinhold, Inc., Oradell, N.J.) relating to Chestnutt, a copy of which went to the jury as Exhibit 4. It is A1-7 hereto, photographs excluded. Mr. Harsham's first sentence reads:

> "Wall Streeters call George A. Chestnutt, Jr. a maverick, and they may be right."

Mr. Harsham reported Chestnutt as saying (A2):

> "That's because the majority let their emotions dictate their investment moves." "It's the worst thing they can do", says Chestnutt, "the stock market will do whatever it has to do to prove the majority wrong."

The "Redbook" has outlined Chestnutt's selection of objective data, and includes for 23 years through 1968 the actual percentage market performance (plus *and* minus) of 63 industry groups compared to the percentage plus *or* minus of the 800 stock geometric average originated by Chestnutt in 1947* and the Dow Jones averages.

The "Redbook" under 24 headings outlined Chestnutt's philosophy on the basis of which each week since 1951 he has written, signed and published throughout the world a two page opinion letter on the stock market with 4 pages of statistics. Weekly issues (March 1969-April 1970, with certain gaps) went to the jury as Exhibit 3 (465a-570a).

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* This original undistorted percentage concept, applied initially in 1947 to 400 stocks was increased successively to 1,000 stocks by 1970. The concept has been emulated by the "Value Line Geometric Average" now widely reported in various publications.

Like the "Redbook", each weekly publication of "American Investors Service" has been filed with the Securities and Exchange Commission, as have two decades of registration statements including the prospectuses of American Investors Fund, Inc. describing Chestnutt's analytical methods and each showing ten years investment results.

In May 1968 Dudley E. Miller,* unannounced and unsolicited dropped into Chestnutt's office in Greenwich because a fellow oilman abroad, Mr. Squires, had suggested it. (316a).

At the time of trial Miller for 3½ years had been Eastern Hemisphere Vice President and General Counsel for Occidental Petroleum.

Chestnutt's officer Murray showed him the record, as Miller admitted, of *all* managed accounts over a period of "several years" which Miller further admitted " . . . varied from account to account, but certainly for 2 to 3 years at a minimum". (330a). Miller was given a copy of the "Redbook" (Exhibit 5) which he described as "very complete and expresses a lot of the feelings I have in the stock market". (277a).

Nine months later, and after receiving in the mail a copy of Harsham's ten column article in *Medical Economics*

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* He acted for his wife, Plaintiff-Respondent throughout. The Millers live in London. He began his career as staff counsel in New York for U.S. Life for 3 years doing international, tax, corporate, labor and insurance law; went with ARAMCO in New York, then to Holland and then to Arabia doing general practice and contract problems. From 1963 to 1969 he was general counsel for another consortium, Oasis Oil Company, in Libya. After a period with "Oxy-Libya" and having an additional office in Paris, Mr. Miller had for 3½ years before trial been Occidental Petroleum's Eastern Hemisphere Vice-President and General Counsel in London (257a-266a). Mrs. Miller, formerly a nurse, had done post graduate work at Johns Hopkins University in neurosurgery (101a).

(Exhibit 4) and after conferring with the fellow oilman abroad, in February 1969 Miller engaged Chestnutt to place, buy and sell orders with her long-standing broker, Spencer Trask & Company, for which Chestnutt received a quarterly fee of $325.00, plus one quarter of 1%, which amounted to $653.26 on the initial portfolio value of $131,305.62 as of February 28, 1969. (680a).

Miller received physically in Tripoli a confirmation slip within 5 to 8 days for every portfolio transaction, as well as monthly reports showing exact portfolio and cash positions. (281a-282a, 321a). He also received each week within 5 to 8 days Chestnutt's current opinion and the factual information upon which the opinion was based in the six page publication American Investor's Service. (Exhibit 3)*.

The account prospered for a few months. The one-page engagement of Chestnutt could be terminated at will (Exhibit 1, 463a) and was accompanied by a one page limited power of attorney furnished to her broker Spencer Trask

* Each published letter (filed with the Securities and Exchange Commission) included:

1. The *actual* closing prices of 800 stocks.
2. The *actual* Dow Jones average and weekly change, plus charts of other averages.
3. The *actual* American Investors 800 stock geometric average and weekly change.
4. The ranking of each of such 800 stocks in accordance with their "relative" market strength, ranking from 0 to 99.
5. The ranking of 65 industry groups, and the individual ranking of the 800 stocks within its group.
6. The number of the 65 groups which had advanced in fact and the number of groups which had declined in fact.
7. A proprietary "Trend Oscillograph" showing plus or minus in figures where the market as a whole appeared to be trending in the Adviser's opinion.
8. A narrative opinion letter expressing the Adviser's interpretation of what the "market trend evidence" appeared to be.

& Company authorizing only acceptance of buy and sell orders. (Exhibit 2, 464a)*.

The Jury Was Required To Try Written and Published Opinion.

Miller's counsel closing to the jury (427a, ff.) itemized his bill of attainder separately against the 20-year old Redbook (Ex. 5), the weekly opinion letter (Ex. 3) and the *Medical Economics* article (Ex. 4), described as a "testimonial", and the "D minus" rating by *Forbes Magazine* of American Investors Fund, Inc., a different client. The Judge's charge (A11) lumped them together.

* Chestnutt never had control or possession of assets. Chestnutt has no affiliation or interest in brokerage or underwriting and has always squarely conformed to the high standards set for investment advisers in *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963), that there be no conflicting activity to impair investment judgment, stating at 190:

> ". . . not engaged in any activity such as security selling or *brokerage*, which might directly or indirectly bias an investment judgment . . .". (Emphasis added)

And the Court stated earlier

> "The report stressed that affiliates by investment advisers with investment bankers, or corporations might be 'an impediment to a disinterested, objective, or critical attitude toward an investment by clients . . .'" (at 187-188),

and further:

> "The report incorporated the Code of Ethics and Standards of Practice of one of the leading investment counsel associations, which contained the following canon:
>
> "[An investment adviser] should continuously occupy an impartial and disinterested position, as free as humanly possible from the *subtle* influence of prejudice, *conscious or unconscious;* he should scrupulously avoid any affiliation, or any act, which subjects his position to challenge in this respect." (at 188, emphasis the Court's)

Not a single security transaction was identified by either as claimed to be fraudulent. Not a single existing fact was challenged.

(A) As to the Redbook

Mentioned repeatedly, a few quotations suffice:

> "Look at the red book or what I have been calling the red book. I want you to look first, if you will, at all the graphs, all the charts. There are a lot of them, 2, 3, 4, 5, they go on, 6, then you go in the back and count a lot more." (430a)
>
> "Mr. Miller testified exactly to the contrary, that he was never told of a limitation of this book. You've got some cartoons in here too. Page 24, a poor fellow is on the train going the wrong way and wants to get off. Page 14, I have another cartoon, somebody at the betting window down at Yonkers or someplace like that. (431a)
>
> * * *
>
> "I'm going to go with them." and he was particularly impressed by this technique, tactic, sometimes it's called of selling short. He is a believer in the short sale and he made an inquiry about the short sale. (432a)
>
> "* * * The book talks about the value of the short sale." (432a)
>
> "There's also another statement in here that's pretty interesting and Mr. Chestnutt, I believe, testified to it. Page 7, it says 'This geometric average was designed to satisfy the need for a scientifically accurate index of average general market performance.' He said and he testified that it is a scientifically accurate tool. If you find it is not a scientifically accurate tool, I think you would find too that that was a violation of the Securities Law." (433a)

(B) As to Senior Editor's Harsham's 10-column article published in *Medical Economics*:

> "Mr. Miller in May went to see Chestnutt. A while later, he was mailed this document, Profiting From Stock Market Psychology. We claim that this document is a testimonial, a testimonial to the ability of Mr. George Chestnutt, the boss, as Mr. Lee characterized him today, the boss of Chestnutt Management and Chestnutt Corporation. And we maintain that this is a violation of a Federal Securities Law." (430a)

(C) As to the "D minus" rating by *Forbes Magazine* of American Investors Fund, Inc.:

> "The organization that he invested with had a D or D minus rating from Forbes." (438a)
>
> * * *
>
> "This, on top of the D rating in the market. . ." (439a)

(D) As to the Weekly Stock Market Survey (Ex. 3):

There was no challenge to any fact in four pages, or claim that Chestnutt did not act in accordance with his opinion expressed in two pages.

> "The monthly brokerage statements . . . was just a history for a period of 30 or 31 days, whatever. The only information that he had as to the *future* of the market is right here in Exhibit 3. The only *prognostications* made that were available to Mr. Miller were right here . . ." (456a) (Emphasis added)
>
> ". . . this thing they call the Stock Market Survey, I think is perhaps the most important." (434a)
>
> "Now, the Stock Market Survey used this word 'bullish' as I read to you before. Was the American securities market in the period February 1969 to April of 1970 bullish?

> Remember Mr. Quick's example about the tide. Mr. Quick testified that in his opinion it was bullish. He testified that it was bullish up to about November 26, 1969, and thereafter, through the period in question and indeed through most of May, the market was bearish. The tide was going out. In no week during that period did he testify the tide was coming in." (435a)

The trial judge rejected the crucial portions of Chestnutt's proposed charge (A8). He made the charge printed A11, permitting the jury to treat a magazine article as a "testimonial" in violation of the Act, a book as criminal, and an *opinion* as to the *future* as a material fact, imposing absolute liability. He charged:

> "It is not necessary to prove that the maker of the statement had a guilty intent. It is sufficient if the statement was made without reasonable grounds or made recklessly.
>
> If you find that the statements that were made if, in fact, they were made, were statements of opinions relative to the conditions of the securities market, it doesn't make any difference because if the opinion was given by a professional person whose services had been engaged, the opinion was false because of a lack of due care and a defendant would be liable." (A13-14)

Throughout the 1975 trial, a half-year before *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976), "advertising" and "testimonial" under Reg. 275.206(4)-1 were utterly confused with the statutory words "device, scheme or artifice to defraud a client" (§206(1)) and the statutory words "fraudulent, deceptive or manipulative" (§206(4). As applied, the Regulation not merely exceeded the legislative grant, but violated free speech and was vague contrary to due process.

Reasons for Granting the Writ

I

Left standing, the decisions below permit jailing a financial writer for a 20 year old book.*

Left standing, the decisions below would endanger an author selling his book, unless accompanied by the "D minus" grade of a hostile reviewer.

Left standing, the case creates absolute liability—not only for writing—but even for being *written about* (Ex. 4, A1-7). While the first sentence of the ten-column magazine article by the Senior Editor of *Medical Economics* does indeed refer to Chestnutt as a "maverick", this "animal metaphor" even when added to "bullish" and "bearish" does not resemble a "pig in the parlor". *FCC* v. *Pacifica Foundation*, —— U.S. ——, 98 S.Ct. 3026, 3041, 3049 (1978). Moreover, one should add, neither the Redbook in its many editions (Ex. 5) nor the weekly opinion letter (Ex. 3), both filed through the years with the SEC, has over the decades occasioned "any of the available sanctions [the SEC] has been granted by Congress". *id.*, 98 S.Ct. at 3030.

As a consenting adult and California and New York international lawyer, Miller spent May 1968 through February 1969 reading the Redbook (Ex. 5) and the magazine

* Our fatuous hope when privileged to be of counsel a quarter-century ago in *Joseph Burnstyn, Inc.* v. *Wilson*, 343 U.S. 495 (1952)—the year Chestnutt first published his Redbook—was that the unparalleled concurring opinion of Mr. Justice Frankfurter had forever banished silliness, as well as terror and punitive damage, where some regulation may be permissible.

article (Ex. 4), all the while a bull-market raged ever higher. During this nine-month gestation, had he been besieged with sound trucks blaring their contents, all Justices would have agreed that the contents could not be censored, or punished. *Kovacs* v. *Cooper,* 336 U.S. 77 (1948).

While Chestnutt is a writer and publisher and not a national bank, it must be recognized, *First National Bank, etc.* v. *Bellotti,* 46 L.W. 4317, 4378, Note 31:

> "... The First Amendment rejects the 'highly paternalistic' approach of statutes like §8 which restrict what the people may hear. *Virginia State Bd. of Pharmacy* v. *Virginia Citizen Consumers Council, Inc.,* 425 U.S., at 770; see *Linmark Associates, Inc.* v. *Township of Willingboro,* 431 U.S., at 97; *Whitney* v. *California,* 274 U.S. 357, 377 (1927) (Brandeis, J., concurring); *Abrams* v. *United States,* 250 U.S. 616, 630 (1919) (Holmes, J., dissenting)."

The *Bellotti* case completes the interweaving of public policy free speech and commercial free speech, irrespective of the speaker.

But the decisions below go far beyond the evil perceived in *New York Times, Inc.* v. *Sullivan,* 376 U.S. 254 (1964), and deprive Chestnutt even of the defense of truth of every fact stated. The decisions below impose absolute and punitive liability for opinion.

The decisions below would hang actuaries for epidemics and drown messengers in wells. They exclude financial writing from free speech.

II

We plagiarize and adopt the reasons set forth in the petition in *Fleschner* v. *Abrahamson* (No. 77-1279, *cert. den.* May 15, 1978) which two Justices would have granted, referred to *supra,* p. 4.

We add that everything decided and said in *Blue Chip Stamps* v. *Manor Drug Store, Inc.,* 423 U.S. 884 (1975) applies even more to alleged fraudulent failure to "sell short".

We mention again that *Hochfelder, supra,* was decided after the trial judge made his charge.

For convenience we reprint in the margin notes 7 and 8 (page 8) from the *Fleschner* petition.*

* "[7] *Lewis* v. *Transamerica Corp.,* No. 75-1285 (9th Cir., docketed 1975) (argued May 12, 1977).

[8] The district courts have divided on the issue: *Sullivan* v. *Chase Investment Services of Boston,* 434 F.Supp. 171 (N.D. Cal. 1977) cause of action implied after dismissal of 10b-5 claim); *Angelakis* v. *Churchill Management Corp.,* [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,285 (N.D. Cal. 1975) (cause of action implied); *Lewis* v. *Transamerica Corp.,* No. C 73-2180 (N.D.Cal. 1974) ("no Federal jurisdiction" and no right of action; oral decision by District Court, *see* transcript of argument held Sept. 27, 1974 at 10), *appeal argued,* No. 75-1285 (9th Cir., May 12, 1977); *Bolger* v. *Laventhol, Krekstein, Horwath & Horwath,* 381 F.Supp. 260 (S.D. N.Y. 1974) (cause of action implied); *Greenspan* v. *del Toro,* [1975- 1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,488 (S.D.Fla.) (noright of action), *appeal dismissed for want of prosecution,* No. 74-2943 (5th Cir. 1974); *Gammage* v. *Roberts, Scott & Co.,* [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,760 (S.D.Cal. 1974) (no right of action)."

CONCLUSION

For the foregoing reasons, and those incorporated herein, a writ of certiorari should issue to the United States Court of Appeals for the Second Circuit.

Respectfully submitted,

CLENDON H. LEE
Counsel for Petitioner
Chestnutt Managament Corporation
One Dag Hammarskjold Plaza
New York, New York 10017
Tel. (212) 754-1430

APPENDIX

Exhibit 4

Profiting from Stock Market Psychology

BY PHILIP HARSHAM
Senior editor, Medical Economics

(Photos Omitted)

Wall Streeters call George A. Chestnutt Jr. a maverick, and they may be right. But no single label could do justice to the 53-year-old mutual fund proprietor and money manager. Actually, Chestnutt is a dedicated technical stock analyst who believes that an understanding of the market's technical aspects can benefit any investor. He's convinced he has hit upon a stock analysis system that, properly interpreted, can lead almost surely to extraordinary profits. And *he* may be right.

When Chestnutt came out of Montana in 1946, at any rate, he had only $5,000. Now, some 21 years later, he runs a $225,000,000 mutual fund (American Investors Fund) and heads an investment counseling service whose 250 or so clients must have a minimum of $100,000 each. He also publishes a weekly advisory report (American Investors Service) for which investors "who want to kill their own snakes," as he puts it, pay $240 a year.

"You might say that I'm employed full time," he quipped with a deceptively timid grin, as he ushered me into his blue-paneled Greenwich, Conn., office. Aware that Chestnutt's methods had served him and his mutual fund well, I had come calling primarily to see if some of those methods might be put to practical use by doctor-investors. My conclusion: Some of them can be—and profitably.

"We operate on the basis of technical market analysis, yes," Chestnutt says. "But technical information has to

be interpreted in the light of investor psychology. Anybody can keep charts. I'm more a stock market psychoanalyst."

Behind Chestnutt's probings of the market's psyche is the theory that the best source of information for an investor is the action of the market itself. "I usually couldn't care less what a company does," he says. "What I want to know is how its stock has been performing; that's the best clue to how it's likely to perform in the future."

What about such fundamentals as a company's earnings, profit margin, debt position, and growth rate? "All those things are reflected in the market action of the stock," Chestnutt says. Besides, studies he's made over the years indicate that economic factors have only a 15 percent correlation with stock market averages. So he concludes that the market's action is rooted only 15 percent in economics and 85 per cent in psychology. Chestnutt concedes that he and his staff do correlate their technical information with current economic factors. But, he says, "You have to recognize above all that stock prices move up or down because real live people are bidding them up or down." An astute technical analyst can determine by watching the charted trends of prices and trading volume the points at which those people are most likely to be selling or buying.

That's because the majority let their emotions dictate their investment moves. "It's the worst thing they can do," says Chestnutt. "The stock market will do whatever it has to do to prove the majority wrong." Meanwhile, the investor, who lets himself be guided only by accurate technical analysis, totally unencumbered by emotions, can wait for the opportunity to pick up bargains. "All he has to do is hold out his basket," as Chestnutt puts it, "and catch the falling shares."

Can the average doctor-investor play that game? Chestnutt thinks so, "if he's willing to take the time to study

charts and relate them to invester emotions." But even if he can't play it, he can benefit by learning how the professionals play it. The fundamentals behind the psychology of the market are these: At any given time, some investors may have gains in a stock and some may have losses. Those with gains want to safeguard them, and, if possible, build them higher. The motives of those with losses are a bit more complex. Some will opt to cut their losses short by selling out early when the stock's price begins to slide; some will sell the moment a minor rally returns the stock's price to the level they paid; and some will hold on doggedly, awaiting a turnaround. "Everybody has his own flash point," explains Chestnutt. The better acquainted an investor is with the stages at which those flash points might occur, the more profitable his buy and sell decisions will be.

Take a stock like du Pont, as an example. A couple of years ago, it was selling at around 260. It was a "happy-people" stock, to use Chestnutt's terminology, because many of its shareholders were long-term investors with immense profits in it. But those who bought in at 260 or so now have little reason to be happy; from that level, du Pont began a decline that eventually exceeded 100 points.

Analysts charting du Pont's decline could see at various points just what shareholders' emotions were prompting them to do. Eventually, the chart pattern indicated that most of those who intended to get out had gotten out. Du Pont stock drifted listlessly between 145 and 155. It seemed to have hit bottom.

Was that the time to buy? Those who thought so found themselves with gains of 20 to 30 points within very few months. The stock rose for technical reasons even while the company reported disappointing earnings.

Even those stocks in a strong uptrend may rise and fall from time to time. In the Chestnutt lexicon, those price

movements are intermediate-term fluctuations within a major trend. So a stock may be hitting intermediate-term bottoms and tops while the long-term bottom or top is nowhere in sight. The trick, then, is to buy on the intermediate-term bottom, stay with the stock until it approaches its intermediate-term top, then sell before it heads for another intermediate-term low. If the long-term price trend is up, Chestnutt observes, the chances are always good that the next intermediate-term low will be a bit higher than the previous low and that the next intermediate-term high will be a bit higher than the previous high. But regardless of long-term trends, the investor who waits for the dips to occur to do his buying stands to boost his profits.

That Chestnutt approach to buying low and selling high raises some questions: How do you know that the stock isn't going lower—much lower—than the point you've chosen as the intermediate-term bottom? Or how do you know that it isn't going to soar right on through the point that you've determined as the probable intermediate-term top? How do you, in fact, know that you have a stock that's going to do anything at all?

George Chestnutt's answer is, "You have your charts. You figure it out!" It should be noted that Chestnutt has the mathematical mind of an engineer, which indeed he was until his stock market values began taking more time than his job with a Montana utility company. He reads stock market charts as easily as others read the printed word—maybe because he started charting stocks at the age of 13.

A key factor in Chestnutt's method of analysis is the trend of upside and downside volume—the number of shares traded at prices higher than the previous day's prices and the number traded at lower prices. Those

trends, whether applying to the market as a whole or to individual stocks, give a good indication of how bullish or bearish the investing public is at any given time.

It's market "psychoanalysis" of this type that Chestnutt believes an individual investor could be doing for himself. "Everything he needs to work with is published daily in The Wall Street Journal and other newspapers," he says. In these days of computerization, the job is made easier. Most brokers can give you total upside and downside volume of stocks listed on the New York Stock Exchange simply by pressing buttons on their market monitors.

Here's how Chestnutt explains the principle of volume analysis to subscribers to his weekly advisory service:

"If you had unlimited capital, you could test the market for any stock by alternately throwing in large buying and selling orders. Suppose you wanted to test the market for U.S. Steel; that is, determine which was heavier, supply or demand. Suppose steel is selling at 40, and the market is quiet.

"You start giving your broker buy orders until you have forced the price up to 41. At that point, you stop to note that it took 15,000 shares to put the price up a point. During that time, other people bought 10,000 shares so that the total volume in U.S. Steel was 25,000 shares.

"You wait a while because you've created a little excitement by your buying, which is the sort of thing that attracts the attention of others to the stock. Let's suppose that U.S. Steel falls back and stabilizes at 40½. You might conclude that your buying 15,000 shares had caused a ½-point increase in the price.

"Now, you make another test by giving your broker sell orders until you have forced the price down one full point to 39½. Again you stop and note that it took only 10,000

shares to put the price down a point. During that time other people sold 5,000 shares so that the total volume to drive U.S. Steel down a point from 40½ to 39½ was only 15,000 shares, against 25,000 to put it up from 40 to 41. Again you sit back and watch it, and you observe that the price has now apparently stabilized at 39⅝. What conclusion could you draw?"

The conclusion would be obvious, says Chestnutt: The stock is more likely to go down than up. The reasoning goes like this: More shares were required to drive the price up than were needed to drive it down. You and others are left with an excess of 10,000 shares while the net price has dropped ⅜ point. So supply apparently exceeds demand by 10,000 shares, and the stock is weak.

Fortunately, you don't need to test the market with unlimited capital. "Actual buyers and sellers are doing it for you every day," says Chestnutt. The daily volume figures indicate where majority investment sentiment lies. By recording daily price changes and volume figures over a period of time, it's possible to judge whether a trend is likely to change in the near future.

Volume analysis is just one of the important elements in Chestnutt's sophisticated analytical method—which, he hastens to point out, is certainly not infallible. "But we've run up a pretty good batting average with it," he says. He can point to published figures for American Investors Fund that show gains in per-share net asset value averaging 19 per cent a year since the fund was started. And he can point to a number of managed individual portfolios that show gains of better than 30 per cent a year. "Of course, we can buy on margin or sell short for our managed accounts," he explains.

Those tactics are forbidden to mutual funds; and, as far as Chestnutt is concerned, they should be forbidden to a busy doctor—or any other investor—who can't devote very nearly full time to the market. "If you're going to play the speculator's game," he says, "you should have professional help. Get an investment counselor if your account is large enough to make his fees worthwhile. And if it isn't that large you'd be wise not to play that game at all."

As a man who manages millions for others, Chestnutt has some thoughts on how those who use investment counselors can do so to best advantage. "I prefer to be given full discretion," he says. "I might make a wrong move for an account. But, obviously, I'm not going to make a move that I think will be wrong—the better my clients' accounts look, the better I look. Still, some clients prefer to tie your hands." Some specify that no margin trades or short sales will be made for their accounts. Some rule out purchases of liquor or tobacco company stocks. "That's all right with me," Chestnutt says, "so long as they recognize that imposing such restrictions on me might cut down their gains. Most investors do. But, you know," he grins, hooking his thumbs Western-style under his belt, "some people complain even if they're hanged with a new rope."

Petitioner's Proposed Charges

"1. There is no basis for liability on the ground that plaintiff's account was worth less at the time it was sold out on orders of the plaintiff's husband than it was earlier.

"2. You are not to consider whether defendants did a good job, or not so good, or a poor job.

"3. You are to remove from your minds all questions except whether defendants acted fraudulently or deceitfully.

"4. To find for the plaintiff you must consider whether defendants set out, on purpose, to mislead plaintiff. You cannot consider whether defendants are as good, or better, or worse in their skill in investments than you might be, or someone else might be.

"You may believe that defendants are more optimistic and have greater confidence in their abilities than you have, or is warranted by the facts, but that is not ground for finding any liability.

"5. To find any liability you must be convinced by a preponderance of clear and convincing evidence that the defendants made false representations of a material fact.

"By false, you must understand something untrue, and that the defendants knew it was untrue when it was made.

"In addition you must find this falsity related to something material, which means important, and this was what led or induced and caused the plaintiff to enter into the advisory agreement.

"What type of statement, true or false, would lead this plaintiff whose husband acted for her, to make the agreement? You must understand that the husband acted for his wife throughout, and his knowledge and experience

and skill must be considered as to what would lead him to act.

"Since, when the agreement was made, the account was to be managed in the future, in order to find for the plaintiff, you must find that when the agreement was made, defendants did not intend to carry it out—that is, the management of the account—according to their best ability.

"7. Thus far, to decide in favor of plaintiff you will have had to consider, and on the basis of the preponderance of clear and convincing evidence, decided that defendants deliberately and on purpose; first, hid something from the plaintiff or told an untruth about something important or material, and second, that plaintiff and her lawyer-husband who had the experience of the world which is in the record was fooled by it, and relied upon it.

"In short, to reach this point in your deliberations, you must have decided after being persuaded on the basis of clear and convincing evidence that:

(a) defendants concealed or misrepresented the true facts, and did not intend to do as well as they could with plaintiff's account and lied when they undertook to manage the account, and also that

(b) Mr. Miller, the plaintiff's husband and agent—as a lawyer and executive of many years experience with international oil companies—relied on the misrepresentation and was in fact fooled or misled by the false statement or statements.

"8. These are preliminary steps up to this point.

"You recall that it is undisputed that stock prices in general went down from the time the management account was opened.

Petitioner's Proposed Charges

"You will also remember that plaintiff's husband by cable ordered the stocks sold.

"You must take these undisputed facts into account.

"Since these facts did occur, namely, falling stock prices and the direct instructions of plaintiff's husband to sell, then, in order for you to find any injury or damage, you must be satisfied that a specific stock in the account on the day the account was ordered to be sold was previously bought in bad faith, without regard to whether plaintiffs thought it was a good purchase for the account.

"Thus, even though you may have decided that the making of the agreement was induced by misleading statements or concealment, to find any liability or injury you must further find that a specific stock or specific stocks held at the time the account was liquidated was bought for some other reason than the best interests of the account.

"As to any stock held in the account at the time plaintiff's husband ordered the account sold out and bought in bad faith by the defendants, you may then fix the measure of damage for each of such stocks at not more than the difference between the purchase price of such stock and the price at which it was sold."

District Judge's Charges

The Court: Ladies and gentlemen, I am sure you will agree that this has been a little bit out of the ordinary garden variety case that juries usually hear. I thought the case was interesting. At least we had a vicarious trip to some exotic lands and a limited view of Wall Street by some experts. And with due respect, I thought Mr. Miller's voice was not unlike the late Sidney Greenstreet's.

But whether a case is interesting or not, I am sure you know that the most important part of the case is the part that you people are going to play in a little while because you are going to decide whether or not the Chestnutt Management Corporation owes any money to Mrs. Miller and, if so, how much. And I suggest to you that you decide those issues according to the oath that you took some weeks ago when you told us through the Clerk that you would well and truly try the issues joined and a true verdict give; and I suggest further that you cannot do it according to your oath if for one minute you let emotions like bias or prejudice or sympathy enter into your thinking or your deliberations. I know that if you do it according to your oath, you will do it the way you resolve an important matter at home or in business, and if you do that, then justice will be done and that is all that anybody asks.

Now, this is a civil lawsuit and in a civil lawsuit the burden is on the plaintiff to prove every essential element of her claim by a preponderance of the evidence. This test, the preponderance of the evidence test applies to plaintiff's first claim under a Federal Statute which I will explain.

The test with regard to her second claim which is based upon fraud is that fraud must be strictly proven and the evidence must be clear, precise and unequivocal.

Now, if the plaintiff fails in the burden that is imposed upon her, then your verdict must be for the defendant. If you find on weighing all the evidence that the scales are even balanced, then your verdict must also be for the defendant because, obviously, the plaintiff has not persuaded you. But if you find on weighing all the evidence that the scales tip ever so slightly in favor of the plaintiff, then, of course, she has persuaded you and she is entitled to your verdict.

Now, the plaintiff, Mrs. Miller, sues two corporations, one called the Chestnutt Management Corporation and the other, Chestnutt Corporation. You are to concern yourself only with the Chestnutt Management Corporation since that is the company with which she made her investment agreement.

Now, Mrs. Miller, as I indicated, has two claims which she advances. Either one or both, if proved, will entitle her to the damages that she has proved.

The first claim is based upon a Federal Statute which is called the Investment Advisers Act of 1940. That law provides in part it is unlawful for any investment adviser by the use of the mails or any means of interstate commerce to employ a device or scheme or artifice directly or indirectly to defraud a client. These words include the publication or circulation of any advertisement which directly or indirectly refers to a testimonial of any kind concerning the investment adviser or concerning any advice analysis or report or other service rendered by the investment adviser.

It is Mrs. Miller's claim that the defendant, Chestnutt Management Corporation did employ such testimonials and also the Company employed graphs and charts and other formulas which implied that these graphs and charts

and formulas could be used to determine what securities to buy or sell and when to buy or sell without disclosing prominently the limitations on such graphs or charts or formulas. If you find that the defendant did these things, you may find that such are in violation of the Investment Advisers Act or if you find that any advertisements or brochures or surveys of the defendant, Chestnutt Management Corporation, which were conveyed by the mails contained any untrue or false statement of a material fact, you may find that this also is a violation of the Act.

All this is so because an investment adviser like the Chestnutt Management Corporation occupies a position of trust and as such is a fiduciary upon whom an affirmative duty of the utmost good faith has been imposed and affirmative objection to employ reasonable care to avoid misleading a client.

Now, the second claim that the plaintiff advances is that the defendant, Chestnutt Management Corporation, made false and misleading statements about the condition of the securities market. In order to prevail on this count, the plaintiff must prove by clear and precise and unequivocal evidence, (1) that there was one or more false representations; (2) that the representation was of an existing fact; (3) that it was fraudulently, recklessly or negligently made; and (4) that the plaintiff relied on it and that she was damaged thereby.

It is not necessary to prove that the maker of the statement had a guilty intent. It is sufficient if the statement was made without reasonable grounds or made recklessly.

If you find that the statements that were made if, in fact, they were made, were statements of opinions relative to the conditions of the securities market, it doesn't make any difference because if the opinion was given by a pro-

fessional person whose services had been engaged, the opinion was false because of a lack of due care and a defendant would be liable.

On the other hand, I must tell you that merely because plaintiff's account was worth less at the time it was sold out on the order of the plaintiff's husband than it was earlier, it is not a basis for liability of the Chestnutt Management Corporation. The question is not whether Chestnutt Management Corporation did a good job or not so good or a poor job. If you find liability, you must be convinced with reference to the alleged statutory violation that is the first claim—you must be convinced with regard to the alleged statutory violation, the first claim, by a fair preponderance of the evidence that the defendant employed a scheme or artifice or device to defraud a client.

With reference to the second claim, namely, that the defendant made false representations of a material fact, that is something untrue, and the defendant knew it was untrue when made and that it was material. On the second claim, fraud, as I said, must be proved by clear and convincing evidence and precise.

Remember too that the defendant corporation is not an insurer of plaintiff's account. It is an investment adviser only.

Now, one of the issues in the case which is in every case and that is the question of credibility. In short, who is telling the truth? No one that I know of has come up with a slide rule or a caliper to tell us how to measure it, but everybody agrees that you do it by applying your own God-given common sense and your experience at home and in business. Did the witness have any reason for lying or did he or she have a motive? Was he or she candid and honest? Was he or she interested in the results of the trial?

And was his or her recollection as good as he or she said it was? You determine all of these things based upon your experience at home and in business and, of course, if you find that a person testified falsely to a material fact, you are at liberty to disregard that testimony or you can accept what you believe and disregard what you do not believe or you can, if you wish, disregard that witness' entire testimony.

Now, the question of the credibility of witnesses, of course, is solely within your province. And the rules of evidence do not ordinarily permit a witness to express his opinion. An expert witness, however, is an exception to this rule. A witness such as a doctor or an engineer or a Wall Street broker who has by reason of education and experience become expert in his profession or trade or business may be permitted to state his opinion as to a matter in which he is versed and which is material to the case. He also may state the reasons for his opinion.

You should consider the opinion of the two experts that we had. You can reject the expert's opinion entirely if you conclude that the reasons given in support of the opinion are unsound. And, of course, if you find as I said with regard to another witness, any other witness, that the witness testified falsely to a material fact, you are at liberty to disregard his testimony completely or accept so much as you believe.

Now, if you are persuaded that the plaintiff has sustained her burden of proof on either claim or on both claims by the standards of proof that I have explained, then you approach the question of damages. Damages are a sum of money that will fairly and justly compensate the plaintiff for the loss she has actually incurred.

The mere fact that I have explained what damages are does not mean that I believe that she is entitled to damages. If she has not persuaded you, she is no more entitled to the Chestnutt Management's money than she would be to your money or mine. However, if she has proved that she is entitled to the damages, she is entitled to those damages that she has proved.

And now I am sure you know that your verdict in favor of the plaintiff or of the defendant must in either case be unanimous. If you say that you find in favor of the defendant, that is all you need to say. If you tell us that you find in favor of the plaintiff, then you tell us what the amount of money is by way of damages that will fairly and justly compensate her.

I am sure you know that when you retire to the jury room, you will elect one of your own members as a foreman or forelady and he or she will conduct your deliberations and represent you when you return to Court with a verdict.

And I must now talk to the lawyers for a minute or two in your absence. So, please, excuse us.

* * * *

(The following transpired in the courtroom)

The Court: Ladies and gentlemen, I was told that in repeating the burden of proof that is on the plaintiff in connection with the second or the fraud claim, I added a word that I should not have added.

Fraud must be strictly proven and the evidence must be clear, precise and unequivocal. I think I added the word "convincing". So I'm sorry.

You may retire now. Thanks.

(The jury left the courtroom at 2:10 p.m.)

(Court reconvened at 3:20 p.m.)

The Court: Will the foreman identify himself, please?
The Foreman: Roland Nimo.
The Court: Has the jury agreed upon a verdict?
The Foreman: Yes, sir. We have.
The Court: What is the verdict.
The Foreman: We find in favor of the plaintiff.

District Court Denial of Motion n.o.v., etc.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF CONNECTICUT
Civil Action No. B-477

ELEANOR C. MILLER,
Plaintiff,
vs.

CHESTNUTT MANAGEMENT CORPORATION and
CHESTNUTT CORPORATION,
Defendants.

Defendant Chestnutt Management Corporation's motion for a new trial pursuant to Rule 59(a), Fed. R. Civ. P., and its motion for judgment notwithstanding the verdict pursuant to Rule 50(b), Fed. R. Civ. P., are both denied.

/s/ THOMAS F. MURPHY
Thomas F. Murphy
Senior United States District Judge

Dated: Waterbury, Ct., September 19, 1977.

Court of Appeals Judgment

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
77-7530

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the third day of April one thousand nine hundred and seventy-eight.

Present:

HON. STERRY R. WATERMAN,
HON. WILLIAM H. TIMBERS,
HON. ELLSWORTH A. VAN GRAAFEILAND,
Circuit Judges.

ELEANOR C. MILLER,
Plaintiff-Appellee,
v.

CHESTNUTT MANAGEMENT CORPORATION and
CHESTNUTT CORPORATION,
Defendants,

CHESTNUTT MANAGEMENT CORPORATION,
Defendant-Appellant.

Appeal from the United States District Court for the District of Connecticut.

This cause came on to be heard on the transcript of record from the United States District Court for the District of Connecticut, and was argued by counsel.

Court of Appeals Judgment

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is affirmed in accordance with the Court's oral opinion in open court with costs to be taxed against the appellant.

A. Daniel Fusaro,
Clerk

By /s/ Arthur Heller
Deputy Clerk

Denial of Rehearing

UNITED STATES COURT OF APPEALS

For the Second Circuit

Docket No. 77-7530

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the twenty-second day of June, one thousand nine hundred and seventy-eight.

Present:

Hon. Sterry R. Waterman,
Hon. William H. Timbers,
Hon. Ellsworth A. Van Graafeiland,
Circuit Judges.

Eleanor C. Miller,

Plaintiff-Appellee,

—against—

Chestnutt Management Corporation and
Chestnutt Corporation,

Defendants,

Chestnutt Management Corporation,

Defendant-Appellant.

Denial of Rehearing

A petition for a rehearing having been filed herein by counsel for the defendant-appellant,

Upon consideration thereof, it is

Ordered that said petition be and hereby is Denied.

/s/ A. DANIEL FUSARO
A. DANIEL FUSARO
Clerk

Panel Decision Dictated from Bench

[The following statement does not constitute a formal opinion of the Court and is not to be reported. It shall not be cited or otherwise used in unrelated cases.]

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Docket No. 77-7530

ELEANOR C. MILLER,
Plaintiff-Appellee,

v.

CHESTNUTT MANAGEMENT CORPORATION and CHESTNUTT CORPORATION,
Defendants,

CHESTNUTT MANAGEMENT CORPORATION,
Defendant-Appellant.

Before:

STERRY R. WATERMAN, WILLIAM H. TIMBERS and ELLSWORTH A. VAN GRAAFEILAND,
Circuit Judges.

New York, April 3, 1978

Statement by the Court at disposition of appeal in open court.

JUDGE TIMBERS:

I assume counsel are aware of the practice in this Court increasingly followed by us to rule from the bench in a

case where we consider it appropriate to do so. We are going to do so here. Our disposition of the case from the bench does not reflect in any way adversely upon arguments or briefs of counsel; on the contrary, just the opposite. Counsel have so aided us in their briefs and oral arguments as to enable us to rule from the bench.

The short of it is, we affirm. Briefly the following are the grounds of our affirmance. In this action, authorized under the law of this Circuit by *Abrahamson* v. *Fleschner*, 568 F.2d 862 (2 Cir. 1977), the case was submitted to the jury on two claims. First, that defendant Chestnutt had violated Section 206 of the Investment Advisers Act of 1940 and Rule 206(4)-1 promulgated thereunder. Secondly, that defendant Chestnutt had committed common law fraud. The jury returned a general verdict in amount of $53,000 in plaintiff's favor on October 3, 1975. Chestnutt moved for judgment n.o.v. or in the alternative for a new trial. The district court denied the motions on September 20, 1977. Chestnutt appeals from the order denying those motions, but not from the judgment itself.

With respect to the claim of insufficiency of the evidence, as indicated or reflected by the statements from the bench during the course of the argument, particularly by my two colleagues, Judge Waterman and Judge Van Graafeiland, we hold that plaintiff presented sufficient evidence from which the jury could have found that Rule 206(4)-1(a)(3) was violated by Chestnutt's representations about its systems of graphs and tables and "Trend Oscillographs", without adequate disclosure of their limitations. Moreover, Chestnutt's intentional failure to disclose its prior performance in bear markets we hold constituted a sufficiently material non-disclosure to support a jury finding of common law fraud.

With respect to the charge—on this aspect of our ruling we assume for present purposes that objections to the charge were properly preserved in the district court—the only matter which we believe merits brief comment is Judge Murphy's use of the word "negligently", in the context of his charge, disjunctively with the words "fraudulently" and "recklessly" as an element of common law fraud. After careful examination of the charge, in the context of the entire record, however, we are satisfied that this does not require reversal, for the reason that, where one makes a negligent representation in violation of a duty of care, scienter, if indeed it is required, is imputed. In support of that we find the following cases to be controlling: *Isen* v. *Calvert Corp.*, 379 F.2d 126, 129-30 (D.C. Cir. 1967), *cert. denied*, 389 U.S. 961 (1968); *Stein* v. *Treger*, 182 F.2d 696, 699 (D.C. Cir. 1950); *Anderson* v. *Tway*, 143 F.2d 95, 99 (6 Cir. 1944); *Shane* v. *Hoffman*, 227 Pa. Super. Ct. 176, 181-82, 324 A.2d 532, 536 (1974).

Those are the reasons briefly stated, among others, upon which we rely in affirming from the bench the judgment of the district court.

Thank you very much.

Judge Van Graafeiland:

I would like to note my reservation to the last portion of the opinion just given; that is the part which equates negligent misrepresentation with scienter. I would prefer to base my affirmance on the appellant's failure to take proper exception to the testimony and to the charge.

Judge Timbers:

The record will note Judge Van Graafeiland's statement.

Statutory Appendix

TEXT OF STATUTES INVOLVED

Section 206 of the Investment Advisers Act of 1940, 54 Stat. 852, as amended, 74 Stat. 887, 15 U.S.C. § 80b-6, provides:

PROHIBITED TRANSACTIONS BY REGISTERED INVESTMENT ADVISERS

SEC. 206. It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud any client or prospective client;

(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

(3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. The prohibitions of this paragraph (3) shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction;

(4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

Section 214 of the Investment Advisers Act of 1940, 54 Stat. 856, 15 U.S.C. § 80b-14, provides:

JURISDICTION OF OFFENSES AND SUITS

SEC. 214. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this title or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enjoin any violation of this title or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended, and section 7, as amended, of the Act entitled "An Act to establish a court of appeals for the District of Columbia", approved February 9, 1893. No costs shall be as-

sessed for or against the Commission in any proceeding under this title brought by or against the Commission in any court.

Penalties

Sec. 217. Any person who willfully violates any provisions of this title, or any rule, regulation, or order promulgated by the Commission under authority thereof, shall, upon conviction, be fined not more than $10,000, imprisoned for not more than five years, or both.

Reg. § 275.206(4)-1. (a) It shall constitute a fraudulent, deceptive, or manipulative act, practice or course of business within the meaning of Section 206(4) of the Act, for any investment adviser, directly or indirectly, to publish, circulate or distribute any advertisement:

(1) which refers, directly or indirectly, to any testimonial of any kind concerning the investment adviser or concerning any advice, analysis, report or other service rendered by such investment adviser; or

(2) which refers, directly or indirectly, to past specific recommendations of such investment adviser which were or would have been profitable to any person; *provided, however,* that this shall not prohibit an advertisement which sets out or offers to furnish a list of all recommendations made by such investment adviser within the immediately preceding period of not less than one year if such advertisement, and such list if it is furnished separately: (A) state the name of each such security recommended, the date and nature of each such recommendation (e.g., whether to buy, sell or hold), the market price at

that time, the price at which the recommendation was to be acted upon, and the market price of each such security as of the most recent practicable date, and (B) contain the following cautionary legend on the first page thereof in print or type as large as the largest print or type used in the body or text thereof: "it should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities in this list"; or

(3) which represents, directly or indirectly, that any graph, chart, formula or other device being offered can in and of itself be used to determine which securities to buy or sell, or when to buy or sell them; or which represents, directly or indirectly, that any graph, chart, formula or other device being offered will assist any person in making his own decisions as to which securities to buy or sell, or when to buy or sell them, without prominently disclosing in such advertisement the limitations thereof and the difficulties with respect to its use; or

(4) which contains any statement to the effect that any report, analysis, or other service will be furnished free or without charge, unless such report, analysis or other service actually is or will be furnished entirely free and without any condition or obligation, directly or indirectly; or

(5) which contains any untrue statement of a material fact, or which is otherwise false or misleading.

(b) For the purposes of this rule the term "advertisement" shall include any notice, circular, letter or other written communication addressed to more than one person, or any notice or other announcement in any publica-

tion or by radio or television, which offers (1) any analysis, report, or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or

(2) any graph, chart, formula or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (3) any other investment advisory service with regard to securities.

[Adopted in Release No. IA-121, January 1, 1962, 26 F. R. 10549.]

IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-463

CHESTNUTT MANAGEMENT CORPORATION,

Petitioner,

v.

ELEANOR C. MILLER,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

PETITIONER'S SUPPLEMENTAL BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI AND SUPPLEMENTAL APPENDIX

CLENDON H. LEE
Counsel for Petitioner
Chestnutt Management Corporation
One Dag Hammarskjold Plaza
New York, New York 10017
Tel. (212) 940-8200

October 15, 1979

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No. 78-463

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Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
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Introduction—Intervening Matter

Rule 24(5) of this Court requires us to refer to actions by this Court during the year this petition has been pending.

Probable jurisdiction noted October 1, 1979 in *Consolidated Edison, etc.* v. *Public Service Commission of*

New York (No. 79-134) is even more important than decisions* on "implication" and "securities laws".

We also refer to reargument had October 2, 1979 in *Transamerica Mortgage Investors, Inc.* v. *Lewis* (No. 77-1645) embracing our Question "2" (Pet. p. 4).

The writ in *Transamerica* was granted a few days after petitioner Chestnutt filed its Reply Brief in Support of Petition. *Transamerica* will be decided on the face of the complaint. Accordingly, we print the complaint and answer as a Supplementary Appendix (A31 to A42 bound with this Supplemental Brief) to our petition for writ of certiorari. Pp. A1-A30 are bound with the Petition.

Con Edison, supra, is classic prior restraint.

This *Chestnutt* case is classic punishment for opinion published to the world. It was pleaded, tried, charged to the jury, and affirmed on appeal as unorthodox opinion.

This *Chestnutt* case is so far as we know the first ever to award money damage under the theory of a judicially created private right of action under the Investment Advisers Act.**

This Supplemental Brief focuses first on free speech and press and then the holding in *Redington*:

> "*Given* the fact that our task is to discern the intent of Congress when it enacted §17(a) in 1934 . . ." (slip 14, note 16, emphasis added).

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* We include reference to:

Touche Ross & Co. v. *Redington. Trustee, et al.* (No. 78-309) —— U.S. ——, 99 S.Ct. 2479 (1979).

Burks v. *Lasker* (No. 77-1724) —— U.S. ——, 99 S.Ct. 1831 (1979).

Cannon v. *Univ. of Chicago* (No. 77-926) —— U.S. ——, 99 S.Ct. 1946 (1979).

Teamsters v. *Daniel* (No. 77-753) —— U.S. ——, 99 S.Ct. 790 (1979).

** 15 U.S.C. 80b *et seq.*

The pleadings* show that respondent could not redraft her complaint to circumvent the First Amendment, since publication of opinion is the gist and essence.

In short, this suit never was, and never can be, either federal fish or state fowl.

Probable jurisdiction in *Con Edison, supra,* of blatant censorship under state law of another regulated industry, serves to emphasize the importance of granting the writ herein.**

In *Con Edison* state bureaucrats chopped a few cables to prevent dissemination of what state bureaucrats conjectured other people might dislike, be infected by, or be influenced by.

In this *Chestnutt* case, a federal regulatory statute has been twisted to require a jury to determine the orthodoxy of a twenty-year old book and letters published to the world by a "maverick" who is in the business of publishing financial opinion, and to impose punitive damage for unorthodox opinions, even though no fact was challenged or omission of fact claimed.

Appellant *Con Edison* has been gagged on "controversial matters". Petitioner *Chestnutt* has been punished for a philosophy of "contrary opinion", which turned out to be exactly right, since hard upon respondent's panic liquidation in April 1970 stock prices marched to all time highs by January 1973.

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* As pointed out in our Petition (p. 14), the charge to the jury in October 1975 preceded by several months this Court's decision in *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976).

** The SEC's *Amicus Curiae* Brief (February 1979) in *Transamerica,* pp. 32-33, gives the Commission's estimate of $200 billion under advisement by registered advisers, hardly an invitation to gag or punish financial opinion free speech in an industry perhaps as large as utilities.

ARGUMENT

I.

In Anno Domini 1940—What Congress Knew Then.

In that year the half a thousand Members of the two Houses of Congress included many lawyers.

A. *Free Speech and Press in 1940*

By 1938 this Court had held that the First and Fourteenth Amendments' protection of free speech and press "comprehends every sort of publication which affords a vehicle of information and opinion". *Lovell* v. *Griffin,* 303 U.S. 444, 452 (1938). Applicability of these Amendments to the States and their laws had been held in *Gitlow* v. *New York,* 268 U.S. 652 (1925), and the protection of corporations under the Amendments had been recognized in *Grosjean* v. *American Press Co.,* 297 U.S. 233, 244 (1936).

Thus, the 1940 Congress already knew that the Advisers Act *could not be intended* to censor opinion or punish its publication, even though the "free flow of commercial information" had not yet been protected nor the "highly paternalistic" approach rejected, *Virginia State Board of Pharmacy* v. *Virginia Citizen Consumers Council, Inc.,* 425 U.S. 748, 764, 770 (1976). As we say in our petition (p. 16), in *First National Bank etc.* v. *Bellotti,* 435 U.S. 765 (1978), this Court completed the "interweaving of public policy free speech and commercial free speech, irrespective of the speaker". See also *Carey* v. *Population Service International,* 431 U.S. 678 (1977).

In 1940 half a thousand Congressmen cannot be presumed to have forgotten that *Ex Parte Jackson,* 96 U.S. 727 (1878), prohibited Congress from punishing the Senior

Editor of *Medical Economics* for describing petitioner Chestnutt as a "maverick" in a ten-column article (Exh. 4 in evidence) printed in that professional journal and sending it through the mails, nor could Congress have prohibited petitioner Chestnutt from mailing reprints (with permission), or punished him for doing so. Petition, *passim,* Exhibit 4, printed Petition appendix A1-A7.

B. *The Federal Rules in 1940*

The requirement of Rule 9(b), Fed.R.Civ.Pr., that ". . . the circumstances constituting fraud or mistake shall be stated with particularity", according to Professor Moore* were "well established at common law", citing and quoting as authority *Southern Dev. Co.* v. *Silva,* 125 U.S. 247, 250 (1888):

> "*First,* that the defendant has made a representation in regard to a material *fact; Second,* that such representation is false; *Third,* that such representation was not actually believed by the defendant, on reasonable grounds, to be true; *Fourth,* that it was made with intent that it should be acted on; *Fifth,* that it was acted on by complainant to his damage; and *Sixth,* that in so acting on it the complainant was ignorant of its falsity, and reasonably believed it to be true."

Five decades after that decision and two years after effectiveness of the Federal Rules, Congress in §206(4) of the Advisers Act prohibited "fraudulent, deceptive or manipulative" acts, practices or course of dealing. The Advisers Act did not amend Rule 9(b).

Publication of opinion is not a "public wrong" giving rise to "private action". See Thayer, *Public Wrong and*

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* 2A Moore's Federal Practice ¶9.03.

Private Action, 27 Harv.L.Rev. 317 (1914). *Ubi jus ibi remedium* cannot punish exercise of constitutional right.

The national law school of Ames, Langdell and Thayer, while examining "the better view, Massachusetts to the contrary", nevertheless produced as well the Brandeis of *Erie R.R. Co.* v. *Tompkins*, 304 U.S. 64, 79 (1938):

> "The fallacy underlying the rule declared in Swift v. Tyson is made clear by Mr. Justice Holmes.[23] The doctrine rests upon the assumption that there is 'a transcendental body of law outside of any particular State but obligatory within it unless and until changed by statute,' that federal courts have the power to use their judgment as to what the rules of common law are; and that in the federal courts 'the parties are entitled to an independent judgment on matters of general law' ". (Footnote omitted)

The complaint herein is a gaggle of migratory bootstraps, since there is not even the identification of any "material *fact*" misstated or omitted, nor identification of any security, nor identification of any transaction or course of dealing which was "fraudulent, deceptive or manipulative".

Since, however, ¶1 of the complaint (A31) sandwiches the statute between "diversity"* and "pendent jurisdiction", respondent had the burden to show that the Nutmeg State had some "better view" of *substantive* law than that required by the Advisers Act and Rule 9(b), Fed.R.Civ.Pr.

This she failed utterly to do, as evidenced not only upon the face of the complaint, but evidenced as well through the panel's nomination of wholly stranger jurisdictions, in lieu of any hypothetically different Connecticut "law". As to any eclecticism of substantive law, we juxtapose and

* Respondent alleges citizenship of the Granite State.

repeat from our Reply Brief in support of petition (p. 8, fn.):

> "Since Chestnutt did not peddle real estate or sell anything to, or buy anything from respondent, it is understandable that respondent does not adopt Judge Timbers' invocation (A25) of Pennsylvania backed up sewage (*Shore* v. *Hoffman*, 227 Pa.Super. 176, 324 A.2d 532 (1974)), District of Columbia real property surveys (*Isen* v. *Calvert Corp.*, 379 F.2d 126 (C.A.D.C. 1967)), title to whiskey in Salt Lake City (*Stein* v. *Treger*, 182 F.2d 696 (C.A.D.C., 1950)) or defense on a note for purchase of Kentucky bank stock (*Anderson* v. *Tway*, 143 F.2d 95 (6 Cir. 1944))."

While this Court does not sit to "decide" questions of state law (*Burks, supra*, slip 14), where contrary to *Erie* there has been the "assumption" of a "transcendental body of law outside of any State" (or any jurisdictional eclecticism), it is plain that no conceivable "diversity" or "pendent" case exists, and that after seven and a half years no amendment of the complaint could allege any federal or common law claim under the Federal Rules.

C. *The 1940 Intent of Congress in the Advisers Act*

In 1940 the Federal Rules and the fame of *Erie*, including the "fallacy" of "a transcendental body of law", were two years old, and Congress knew it.

In 1940 Congress did not know that in 1946 a district court would find a "transcendental body" of "basic principles of tort law" to create a private cause of action under a statute enacted in 1934. *Kardon* v. *U.S. Gypsum* (E.D. Pa., 1946), 69 F.Supp. 512, 514. Contrast *Redington*, slip 7.

In 1940 Congress did not know that its express grant in 1947 of *substantive* jurisdiction in Taft-Hartley over "suits for *violation* of [labor] contracts" (emphasis added) would in 1961 incite an "Indication of Congressional intent to create a body of federal law giving rise to a distinctive federal claim . . ." under the different Investment Company Act of 1940.* *Brown* v. *Bullock* (2 Cir., 1961), 294 F.2d 415, 421. Contrast *Burks,* slip 5, "It is true that in certain areas we have held that federal statutes authorize the federal courts to fashion a complete body of federal law. See *Textile Workers* v. *Lincoln Mills,* 353 U.S. 448, 451, 456-457 (1957). Corporation law, however, is not such an area."

In 1940 Congress did not know that in 1964 it would be held for the first time that creation of a private cause of action had already for three decades been a "necessary supplement to Commission action" to enforce a regulatory statute of 1934. *J. I. Case* v. *Borak,* 377 U.S. 426, 432 (1964).

The words in *Redington*: "Given the fact that our task is to discern the intent of Congress when it enacted §17(a) in 1934 . . .", show, we submit, that nothing but the *intent* of Congress in 1940 has any "relevance" (slip 14, note 16).

Transamerica's briefs, including its Supplemental Brief on reargument, and the *Amicus Curiae* brief of Investment Counsel Association of America, Inc. in *Transamerica* show definitively that Congress intended *not* to create any private right of action.

What Congress both did, and intended to do, in 1940 was to require investment advisers to register in order that both disclosure and regulation should be effective.

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* 15 U.S.C. 80a, *et seq.*

The SEC's *Amicus Curiae* brief (February 1979) in *Transamerica,* at page 35, lists the numerous sections of the Advisers Act both as to (1) disclosure and (2) regulation.

Under the statutory scheme and the Commission's broad rule-making authority, for which the SEC's brief cites no less than seven sections of the Advisers Act in a footnote on page 35, petitioner has since 1952 filed Chestnutt's book and its Seventeen Annual Editions (Ex. 5 in evidence), plus decades of weekly opinion letters accompanying unchallenged facts (Ex. 3 in evidence).

The SEC has never sought administrative sanctions or an injunction concerning Chestnutt's publications.

II.

The Crux of This Case Is the First Amendment.

Con Edison's appeal is classic prior restraint.

This *Chestnutt* case is classic punishment for published opinion, where petitioner has been deprived even of the defense of truth of every fact stated.

Whatever arguable avenues of time, place and manner of communication remain open to *Con Edison,* no avenue whatever is open to petitioner *Chestnutt.*

It was the idea itself which created punitive damage.

Respondent elected the federal court, assuming an impenetrable dark rain forest of "securities laws" and "implication". The searchlights of recent decisions of this Court blazingly illuminate that her suit is amorphous in all respects, except that the clear shape of the First Amendment was targeted to the jury which hit its exercise with punitive damage.

Since there can be no "intent" imputed to Congress in enacting the statute in 1940 to violate petitioner's free speech rights, the surest judicial restraint is quick jealousy to protect the full territory of the First Amendment from invasion by imputing such unwarranted "intent" to Congress.

Every consideration recognizing jurisdiction in *Con Edison* should lead to granting the writ herein.

CONCLUSION

It is respectfully submitted that the writ should be granted.

Respectfully submitted,

Clendon H. Lee
Counsel for Petitioner
Chestnutt Management Corporation
One Dag Hammarskjold Plaza
New York, New York 10017
Tel. (212) 940-8200

October 15, 1979

SUPPLEMENTAL APPENDIX

TO PETITION

FOR WRIT OF CERTIORARI

(Pages A31 through A42, Being the Complaint and Answer)

[Appendix Pages A1 through A30 Are Printed and Bound With the Petition Filed September 18, 1978]

Complaint

UNITED STATES DISTRICT COURT

District of Connecticut

Civil Action No. B-447

Eleanor C. Miller,

Plaintiff,

vs.

Chestnutt Management Corporation,
and Chestnutt Corporation,

Defendants.

As and for a First Cause of Action:

1. (a) Jurisdiction of this Court is based upon 28 U.S.C. §1332, in that plaintiff is a citizen of the State of Vermont and defendants are corporations organized and existing under the laws of the State of Connecticut, having their principal places of business in Connecticut. The matter in controversy exceeds the sum of ten thousand dollars ($10,000.00), exclusive of costs and interest.

(b) Furthermore, jurisdiction of this Court is based upon Section 214 and Section 215 of the Investment Advisers Act of 1940 [15 U.S.C. §§80(B)(14) & (15)].

(c) Still furthermore, jurisdiction of this Court is based upon the principle of pendent jurisdiction.

2. On information and belief, defendants at all times material in this complaint were Connecticut corporations having places of business in Greenwich, Connecticut, doing

business under their corporate names. Chestnutt Management Corporation represented itself as the "Investment Counseling Subsidiary of Chestnutt Corporation". During the period involved herein, Chestnutt Corporation was the manager-adviser of American Investors Fund, Inc. (a mutual fund), and was the corporation which printed weekly "Stock Market Survey" reports, distributed to, among others, plaintiff and, on information and belief, to other investment advisory accounts. As the said corporations acted in concert, plaintiff has brought this action collectively against Chestnutt Management Corporation and Chestnutt Corporation.

3. At all times material in this complaint, plaintiff acted through her agent, Dudley E. Miller, her husband, who was, at all times, duly authorized and empowered to act on her behalf. Said Dudley E. Miller was accepted to so act in this capacity by defendants.

4. The business in which defendants were engaged at all times material in this complaint was that of "investment advisers" and/or "investment counsel". On information and belief defendants were registered as such under the Investment Advisers Act of 1940.

5. At all times material in this complaint, defendants held themselves out to the public to be competent investment advisers and/or investment counsel, and, as such, had fiduciary duty in the management of any client's securities and other investments.

6. On or about February 16, 1969, plaintiff entered into a contract with defendants, or one of them, in that she hired and engaged defendants, or one of them, to render

to her investment supervisory services in connection with an account containing certain funds and securities owned by plaintiff.

7. Said account is specifically identified as Account Number 60-609477-6, which on said date was a margin account with the brokerage firm of Spencer, Trask & Company, with offices at 60 Broad Street, New York, New York.

8. In connection with the hiring and engagement of defendants as aforesaid in paragraph 6 hereof, plaintiff delivered to defendant Chestnutt Management Corporation a power of attorney addressed to said Spencer, Trask & Company, authorizing Chestnutt Management Corporation to act as the plaintiff's agent and attorney-in-fact in order to buy, sell (including "short sales") and to trade, on margin or otherwise, for her account in stocks and bonds and any other securities.

9. The aforesaid account at Spencer, Trask & Company, at the time of the hiring and engagement of defendants, or one of them, had a value of about One-hundred thirty-one thousand three-hundred five dollars ($131,305).

10. In accordance with said hiring and engagement, defendants, or one of them, from February 16, 1969, to April 24, 1970, when their services were terminated, bought, sold and otherwise traded securities on behalf of and for plaintiff. For said services, defendants, or one of them, were paid an agreed compensation.

11. At the time of the termination of defendants' services as investment advisers and/or investment counsel, said account had a value of about Fifty-six thousand five-hundred one dollars ($56,501).

12. Plaintiff was induced to hire, engage and contract with defendants, or one of them, for the aforementioned investment supervisory services and/or advice on account of the fraudulent, deceptive and manipulative acts and practices of defendants, in that defendants, or one of them, published, circulated and distributed advertisements:

(a) Where referred, directly or indirectly, to a testimonial concerning services rendered by defendants;

(b) Which represented, directly or indirectly, that certain graphs, charts, formulae and other devices could in and of themselves be used to determine which securities to buy or sell, or when to buy or sell them; and

(c) Which represented that certain graphs, charts, formulae and devices would assist plaintiff in making decisions as to which securities to buy or sell, or when to buy or sell them, without prominently disclosing in said advertisements the limitations of said graphs, charts, formulae and devices, and the difficulties with respect to their use.

13. The publication, circulation and distribution of said advertisements made use of the mails and were in violation of Section 206 of the Investment Advisers Act of 1940 and the rules and regulations promulgated thereunder.

14. As a result of the aforesaid fraudulent, deceptive and manipulative acts and practices of defendants, plaintiff was damaged in the amount of Seventy-four thousand eight-hundred four dollars ($74,804).

As and for a Second Cause of Action:

15.-27. Plaintiff repeats and realleges each and every allegation in paragraphs 1 through 13 of the First Cause of Action as if they were fully set forth herein and numbers them for this Second Cause of Action paragraphs 15 through 27.

28. On various and divers occasions from February 16, 1969 to April 24, 1970, defendants, or one of them, made to plaintiff through their various publications several statements which were false and misleading about the state of the securities market in the United States and which, on information and belief, were known to defendants to be false and misleading, or, in the alternative, should have been known to defendants to be false and misleading.

29. During the aforesaid period, plaintiff and her husband were absent from the continental and territorial United States, being in Africa and Europe, and traveling to different areas between and therein, because the employment of her husband necessitated such.

30. Defendants knew that plaintiff was abroad and traveling for such period.

31. Because plaintiff was abroad and was frequently traveling, as defendants know or should have known, plaintiff relied almost entirely on defendants' management of her account and the investment advice contained and set forth in the publications to which reference is made in paragraph 26 hereof.

32. As a result of her reliance on said false and misleading statements, plaintiff was damaged in the amount of Seventy-four thousand eight-hundred four dollars ($74,804).

As and for a Third Cause of Action:

33.-49. Plaintiff repeats and realleges each and every allegation of paragraphs 15 through 31 of the Second Cause of Action as if they were fully set forth herein and numbers them for this Third Cause of Action paragraphs 33 through 49.

50. From February 16, 1969, to April 24, 1970, defendants bought, sold and otherwise traded various securities on behalf of plaintiff in a negligent and reckless manner, in disregard of their fiduciary duties to plaintiff in one or more of the following respects:

(a) Defendants failed to liquidate certain securities which should have been liquidated;

(b) Defendants failed to maintain a reasonable "cash" or "liquid" position during an uncertain economic period;

(c) Defendants bought, sold and traded securities in plaintiff's account in an inordinate number of transactions —actually "leapfrogging" from stock to stock—in disregard of attendant market conditions and, by doing so, caused plaintiff to suffer losses;

(d) Defendants failed to "sell short" when market conditions necessarily dictated that such be done; and

(e) Defendants failed to follow their own injunction: "Don't overdiversify", with respect to the management of plaintiff's account.

51. As a result of the aforesaid negligence of defendants, plaintiff was damaged in the amount of Seventy-four thousand eight-hundred four dollars ($74,804).

As and For a Fourth Cause of Action:

52.-62. Plaintiff repeats and realleges each and every allegation of paragraphs 1 through 11 of the First Cause of Action as if they were fully set forth herein and numbers them for this Fourth Cause of Action paragraphs 52 through 62.

63. In large part, plaintiff was induced to hire and engage and enter into her contract with defendants as set forth in paragraphs 52 through 62 herein by the representation of the defendants that they would "sell short" from time to time as market conditions dictated.

64. Market conditions, on many occasions during the period February 16, 1969, to April 24, 1970, dictated the employment of the "short sale". Defendants, recklessly and with apparent disregard for the financial interests of plaintiff, failed to "sell short" for plaintiff's account.

65. As a result of the aforesaid misrepresentation of defendants, plaintiff was damaged in the amount of Seventy-four thousand eight-hundred four dollars ($74,804).

WHEREFORE, plaintiff prays:

(1) That the Court adjudge, decree and declare that the aforesaid contract entered into by the parties is void *ab initio,* in that defendants, or one of them, violated Section 206 of the Investment Advisers Act of 1940 and the regulations promulgated thereunder;

(2) For a judgment rescinding the aforesaid contract;

(3) For a judgment against defendants, or one of them, in the amount of Seventy-four thousand eight-hundred four dollars ($74,804);

(4) For a judgment awarding plaintiff interest at the legal rate from February 16, 1969, and costs of this action, including a reasonable allowance on account of attorney's fees and disbursements; and

(5) Such other and further relief as in justice and equity may appertain and which the Court deems proper.

Dated at Stamford, Connecticut this 4th day of February, 1972.

/s/ Peter M. Ryan
Peter M. Ryan, Esq.
McAnerney & Ryan
777 Post Road
Darien, Connecticut 06802

/s/ Samuel S. Cross
Samuel S. Cross, Esq.
Cross, Brodrick & Chipman
500 Summer Street
Stamford, Connecticut 06901

Answer of Defendants

UNITED STATES DISTRICT COURT

District of Connecticut

Civil Action No. B-447

Eleanor C. Miller,

Plaintiff,

vs.

Chestnutt Management Corporation, and Chestnutt Corporation,

Defendants.

RECEIVED FEB 22 1972

Answer of Defendants
Chestnutt Management Corporation
and
Chestnutt Corporation

Defendants Chestnutt Management Corporation and Chestnutt Corporation, by their attorney, Stanley L. Sabel, answering the complaint of the Plaintiff herein, on information and belief, respectfully show to this court and allege with respect to each numbered paragraph of the Complaint, as follows:

As to the Alleged First Cause of Action:

1. (a) Deny knowledge or information sufficient to form a belief, except to admit that defendants are corporations organized and existing under the laws of the State of Connecticut, and have their principal places of business in Connecticut.

(b) Deny.

(c) Deny.

2. Deny that defendant corporations acted in concert, but admit other allegations.

3. Admit.

4. Admit that defendant Chestnutt Corporation was and is engaged in business as an "investment adviser" and that defendant Chestnutt Management Corporation was and is in business as an "investment counsellor."

5. Deny.

6. Deny as to defendant Chestnutt Corporation; admit as to defendant Chestnutt Management Corporation.

7. Admit, except to assert that the correct Account Number was 60-609447-6.

8. Admit.

9. Deny, except to the extent that market quotations for securities held in Plaintiff's portfolio aggregated approximately $131,305 as of February 28, 1969.

10. Deny as to defendant Chestnutt Corporation; admit as to defendant Chestnutt Management Corporation.

11. Deny, except to admit that $56,501 constituted the approximate credit balance after sale of all securities pursuant to Plaintiff's instructions on or about April 24, 1970.

12. Deny.

13. Deny.

14. Deny.

As to the Alleged Second Cause of Action:

15-27 Defendants repeat each and every denial, allegation and admission with respect to paragraphs 1-13 of the Answer to the Alleged First Cause of Action as if they were fully set forth herein and numbers them for this Answer to the Alleged Second Cause of Action paragraphs 15 through 27.

28. Deny.

29. Deny knowledge or information sufficient to form a belief.

30. Deny.

31. Deny.

32. Deny.

As to the Alleged Third Cause of Action:

33-49 Defendants repeat each and every denial, allegation and admission with respect to paragraphs 15-31 of the Answer to the Alleged Second Cause of Action as if they were fully set forth herein and numbers them for this Answer to the Alleged Third Cause of Action paragraphs 33-49.

50. Deny.

51. Deny.

As to the Alleged Fourth Cause of Action:

52-62 Defendants repeat each and every denial, allegattion and admission with respect to paragraphs 1-11 of the Answer to the Alleged First Cause of Action as if they were fully set forth herein and numbers them for this Answer to the Alleged Fourth Cause of Action paragraphs 52 through 62.

63. Deny.

64. Deny.

65. Deny.

Affirmative Defense

The complaint fails to state any claim upon which relief can be granted against either defendant Chestnutt Corporation or defendant Chestnutt Management Corporation.

Wherefore defendants Chestnutt Corporation and Chestnutt Management Corporation demand judgment dismissing the complaint herein, together with the costs and disbursements of this action.

/s/ Stanley L. Sabel
Stanley L. Sabel, Esq.
Attorney for Defendants
Chestnutt Management Corporation
and Chestnutt Corporation
P. O. Box 2500
Greenwich, Connecticut 06830
Tel: (203) 661-5010

In The

Supreme Court of the United States

October Term, 1978

No. 78-463

Chestnutt Management Corporation,

Petitioner,

v.

Eleanor C. Miller,

Respondent.

On Petition For a Writ of Certiorari To The United States Court of Appeals for The Second Circuit

RESPONDENT'S BRIEF IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI

Peter M. Ryan
10 Corbin Drive
Darien, Connecticut 06820
(203) 655-9708

Samuel S. Cross
500 Summer Street
Stamford, Connecticut 06901
(203) 359-4300

Counsel for Respondent

Cross, Brodrick & Chipman
Of Counsel

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October Term, 1978

No. 78-463

CHESTNUTT MANAGEMENT CORPORATION,

Petitioner,

v.

ELEANOR C. MILLER,

Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI

PRELIMINARY STATEMENT

The respondent, Eleanor C. Miller ("Mrs. Miller") respectfully requests that this Court deny the petition of Chestnutt Management Corporation ("Chestnutt"), for a writ of certiorari to the United States Court of Appeals for the Second Circuit to review a judgment entered on April 3, 1978. That court, without a report-

ed opinion, affirmed from the bench the judgment of the District Court of Connecticut entered following a jury verdict for the respondent in the amount of $53,000, and the District Court's order denying the petitioner's motion for judgment n.o.v. or in the alternative for a new trial.

JURISDICTION

The jurisdictional requisites are adequately set forth in the Petition at page 2.

QUESTIONS PRESENTED

The questions presented by the Petitioner are reducible to the following:

1. Were the District Court and Court of Appeals correct in holding there was sufficient evidence upon which a jury could find the petitioner liable to the respondent on either the claim of (1) violation of the Investment Advisers Act of 1940, or (2) common law fraud?

2. Does a finding of fraud under Section 206 of the Investment Advisers Act of 1940, and SEC Rule 206(4)-1, thereunder, prohibiting deceptive and fraudulent acts and practices of investment advisers, infringe the First Amendment freedoms of the petitioner?

3. Does a private right of action exist to remedy violations of Section 206 of the Investment Advisers Act of 1940?

STATUTE AND REGULATION INVOLVED

Sections 206 and 214 of the Investment Advisers Act of 1940, 15 U.S.C. §§80b-6, 80b-14 and SEC Rule 206(4)-1, 17 C.F.R. §275.206(4)-1 (1976) are set forth in the appendix to the Petition at A26 through A30.*

* Numerical references preceded by A indicate pages of the Appendix to the Petition.

STATEMENT OF THE CASE

Material Facts

Mrs. Miller, a former nurse, authorized her husband, Dudley Miller ("Miller"), to act on her behalf with respect to her investment portfolio. Miller, at the time of the incidents involved in this action was an attorney with an oil company, stationed in Tripoli, Libya. Chestnutt, a wholly owned subsidiary of Chestnutt Corporation, is engaged in the business of managing private investment portfolios, and is registered under the Investment Advisers Act of 1940.

Miller, being in Africa, felt that his wife's portfolio required direct and constant supervision in the United States; hence, in May, 1968, during a short stay in the United States, he visited Chestnutt's offices in Greenwich, Connecticut. During this visit, Miller was shown certain ledgers illustrating the history of selected investment accounts then under Chestnutt management, all of which evidenced very substantial earnings and gains. Miller also received a guided tour of the Chestnutt facilities and was shown the complicated charts and graphs allegedly used in the Chestnutt operation.

In his discussions with Chestnutt representatives Miller specifically pointed out the difficulties his overseas location presented in obtaining sufficient information to supervise his wife's investments and that, in any case, he was no expert in the market. He explained his rather basic investment concerns and policies, among them an expectation that securities would be sold to cut losses when they acted contrary to expectations and that short selling was a tactic to be employed in weak stock markets. Miller was given every reason to believe that Chestnutt was qualified and prepared to handle the account in the manner discussed.

At the conclusion of his visit Miller was given a 48 page booklet written by George A. Chestnutt, President of Chestnutt Corporation, entitled *Stock Market Analysis Facts and Principles.* This booklet, referred to at trial as the "red book", emphasized in detail the uses and benefits of various stock market charts and averages including Chestnutt Corporation's 800 stock Geometric Average. Aided by a multiplicity of charts and graphs, the red book discussed with apparent authority such concepts as "Divergent Trends", "Percentage Strength Ratings", and "Ratio Analysis". On the back cover, the booklet added a signed statement by George A. Chestnutt, as follows:

> The most up-to-date source of information for market forecasting is obtained from the action of the stock market itself.

Upon his return to Libya, Miller received numerous communications from Robert A. Whitman, a vice president of Chestnutt responsible for soliciting new clients, with the stated purpose of motivating Miller to engage the services of Chestnutt. These communications contained glowing descriptions of Chestnutt's investment management record, another copy of the red book, and a reprint from an article about George A. Chestnutt's investment theories which appeared in the magazine *Medical Economics.* (A1-A7).

When it became apparent that he would be overseas for the foreseeable future, Miller transferred the management of Mrs. Miller's portfolio to Chestnutt under a fee arrangement. Miller had read the red book and relied on it and on other statements by Chestnutt personnel in opening the account and with respect to how the account would be managed. The portfolio, on February 28, 1969, the opening date under Chestnutt management, was valued at $131,305.12, 26% of which was in cash.

Thereafter Miller began to receive by mail on a weekly basis two Chestnutt publications: *Stock Market Survey,* and *Stock Selection Guide.* Each *Survey* contained a reading from an index called the "Trend Oscillograph", a market timing indicator claimed to be "unique" to Chestnutt. The Trend Oscillograph, heavily relied upon by Chestnutt portfolio managers, was described by Warren K. Greene, President of Chestnutt, as a device by which one could determine whether the market was likely to go up or go down. The *Stock Selection Guide* gave "Percentage-Strength Ratings" to individual stocks. Each stock in Chestnutt's 800 stock Geometric Average was assigned a rating from 0 (the lowest) to 99 (the highest). These ratings were developed, in Greene's words, by George A. Chestnutt through the means of a "very complicated computer formula" and were designed to "give us some facts on which to go on". In discussing these ratings in the red book George A. Chestnutt wrote:

> All we need to know to act profitably is *which stocks are relatively strongest and which stocks are relatively weakest.* Percentage-Strength Ratings provide this information. [emphasis in original].

None of Chestnutt's charts, graphs, ratings or indices contained any disclosure, prominent or otherwise, of their limitations or the difficulties with respect to their use.

Throughout the period Mrs. Miller's account was managed by Chestnutt, the *Survey* exuded unreserved optimism over stock market conditions. With two exceptions, for thirty-six consecutive weeks from July 31, 1969 to April 9, 1970, the *Survey* began its commentary with these precise words: "the general market trend

evidence continues bullish."* Moreover, from June 26, 1969 through April, 1970, the Trend Oscillograph registered plus or "bullish" and from January, 1970 showed extremely "bullish" figures.**

In contrast to this emphatically optimistic description of the stock market which was regularly being sent overseas each week to the Millers, the stock market itself was in the midst of a major and continuing decline, and the value of the Miller stock portfolio in the hands of Chestnutt was dwindling with alarming speed.

Both the stock market averages themselves and expert testimony clearly evidenced that the market was on a steep down-trend from November, 1969 on. Chestnutt's own Geometric Average fell 22% between December, 1969 and April, 1970. In this period the Miller account remained nearly fully invested in securities and contained several securities which held Chestnutt's own Percentage Strength Ratings of less than 10, despite Chestnutt's published warning to sell any security rated under 20.

The resulting effects on the Miller portfolio were disastrous. On May 31, 1969 the account value stood at $139,361.69. By November 30 it was $97,787.82, and on February 28, 1970 the value had fallen further to $83,027.80. On April 24, 1970, when Miller terminated the services of Chestnutt, the value of the account was $56,501.95, a decrease of $82,859.74 or 60% in less than eleven months.

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* The October 9, 1969 *Survey* stated there was little change in the trend evidence which had been described as "bullish" in the preceding nine weeks. On February 5, 1970 the market was described as " oversold".

** The Trend Oscillograph was said to be capable of readings from "plus 30" (the most favorable or "bullish") to "minus 30" (the least favorable or " bearish").

Chestnutt well knew that Miller's only way to keep abreast of stock market conditions while in Libya was through the weekly Chestnutt *Survey* and *Guide*. When Miller received an account statement as of August 31, 1969 showing approximately a $20,000 decline in the portfolio value, he wrote of his anxiety to Lewis Katcher, the Chestnutt portfolio manager. Miller learned of a further substantial decline at the end of November and, on one of his infrequent trips to the United States, spoke to Katcher over the telephone of his concern that Katcher and Chestnutt did not know how to get out of a losing stock, saying: "I think it [a stock] has to drop off your chart before you sell it". At that point Katcher informed Miller for the first time that Chestnutt was rated "D minus" in a falling market.*

Miller went on to say: "we should get out [from under Chestnutt], that they were doing such a bad job", but Katcher "pleaded with me to stay, [saying] I finally have the portfolio in such a condition that I am ready for the turn-around ". Katcher further stated: "Mr. Chestnutt has predicted the last three turn-arounds." Based on this conversation with Katcher, Miller decided to maintain the portfolio with Chestnutt, and returned to Libya about January 1, 1970.

The actual status of the account and its management belied Katcher's assurances. Within two months of his description that the account was "ready for the turn-around", ten securities in the account (over half the portfolio) were sold, and six new securities purchased. Only two of these purchased securities were even included in the 800 stocks accorded ratings by Chestnutt, and all, when later sold, resulted in substantial losses.

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* This was a rating accorded investment managers by *Forbes* magazine. D minus was the lowest possible rating.

Upon receipt of the statement of account as of February 28, 1970, showing a further substantial decline in value, Miller wrote an angry letter to Whitman, who attempted to explain the situation in a lengthy letter dated April 3, 1970, stating: "... we have done a poor job ... [not only because of the market conditions but because] our firm has definitely not been able to coordinate its thinking properly with the market climate as it prevailed up to this point". Whitman's reply continued by repeating the statement that Mrs. Miller's account was in good shape for the next upward movement, and in ironic contrast to the glowing assurances and solicitation materials Miller had received, stated:

> Being located as remotely from our office as you happen to be, you certainly have not had the best point of vantage to understand both the weaknesses and the strengths that prevail in our organization.

Whitman then stated that had Miller been able to examine the Chestnutt record he would have noted the "average to rather poor performance" of Chestnutt in other than sustained bull market conditions. In summation, Whitman asked Miller "to look upon our organization's bull market strength with the hope that we can develop a marvelous recovery for Mrs. Miller's account".

While the account supposedly remained primed for the bull market, the bear market continued and on April 24, 1970 Miller terminated Chestnutt's services by cable, ordering the account sold out.

Proceedings Below and the Decision of the Court of Appeals

Respondent filed suit in 1972 and, after a three-day trial, the case was submitted to the jury on two claims: that the petitioner had violated the provisions of Section 206 of the Investment Advisers Act of 1940 including SEC Rule 206(4)-1, and that the petitioner had committed fraud at common law. The jury returned a general verdict in favor of Mrs. Miller. Senior District Judge Thomas F. Murphy subsequently denied Chestnutt's motion for judgment n.o.v. or for a new trial. (A18).

The Court of Appeals for the Second Circuit affirmed the District Court's judgment in a decision rendered from the bench after oral argument and, pursuant to its practice,* issued a short oral statement. (A23-A25). In affirming, the Court's statement noted a few of the reasons upon which, among others, it relied. First, it concluded that from the evidence presented a jury could have found a violation of SEC Rule 206(4)-1(a)(3) because of Chestnutt's lack of disclosure of the limitations of its system of graphs and tables and the Trend Oscillograph. Moreover, Judge Timbers stated, "Chestnutt's intentional failure to disclose its prior performance in bear markets we hold constituted a sufficiently material non-disclosure to support a jury finding of common law fraud." (A24). With respect to the challenged charge to the jury, there was nothing in the charge to warrant reversal, as is more fully discussed below.

Following the decision of the Second Circuit, Chestnutt sought a rehearing and suggested consideration by the Court *en banc*. The petition was denied, and no active judge or judge who sat on the original panel requested that a vote be taken on the suggestion.

* Rules of the United States Court of Appeals for the Second Circuit, §0.23

ARGUMENT

The Petition fails to raise any issues warranting review by the Supreme Court. One District Judge and three judges of the Second Circuit have passed on and found against the petitioner on the question of the sufficiency of the evidence. The Court of Appeals decision is not in conflict with any decisions of this Court or those of any other circuit. The claim of an infringement of First Amendment freedoms is without merit.

POINT I

THE JURY HAD SUFFICIENT EVIDENCE TO SUPPORT A GENERAL VERDICT THAT CHESTNUTT VIOLATED THE PROVISIONS OF SECTION 206 OF THE INVESTMENT ADVISERS ACT OF 1940 OR COMMITTED FRAUD AT COMMON LAW

The record discloses, and the District Court and Court of Appeals held, that there was sufficient evidence to support a jury verdict of both a violation of the Investment Advisers Act and common law fraud. Respondent submits that on this record further review of the evidence by the Court is not warranted; nevertheless, a summary of the frauds perpetrated upon the Millers by Chestnutt follows, as well as comment on the charge to the jury.

A. There was Ample Evidence of Common Law Fraud and Violations of the Investment Advisers Act

Subsections (1) and (2) of Section 206 of the Investment Advisers Act make it unlawful for an investment adviser "to employ any device, scheme, or artifice to defraud any client," and "to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client". In addition, under authority granted by Subsection (4) of

Section 206, the SEC has promulgated Rule 206(4)-1 defining and prescribing means to prevent fraudulent or deceptive practices by investment advisers. From the very outset Miller was exposed to the practices of Chestnutt which were to operate as frauds on his wife in the handling of her account. Through solicitation materials and personal contact Chestnutt led Miller to believe that it was eminently equipped to manage the account under all market conditions in accordance with policies he asked to be pursued and in accordance with what could reasonably be expected of a prudent investment adviser.

1. Chestnutt, however, intentionally failed to disclose to Miller prior to the transfer of the account that, in fact, its investment performance in a falling stock market was poor and had received the lowest rating given by *Forbes* magazine. As noted above, the Second Circuit held this non-disclosure sufficient in itself to support a jury finding of common law fraud.

2. Miller was not informed that Chestnutt's philosophy of investment management was geared solely to capitalizing on a general upswing in the stock market. Such a limited management philosophy alone was of such material import to the Millers that its non-disclosure under any interpretation of fiduciary responsibility was misleading and a fraud, both at common law and by statute. The evidence of this limited strategy was more than sufficient for the jury finding. Only one short sale was executed and that occurred before the market decline accelerated. George A. Chestnutt at trial, contrary to his representations in the "red book", admitted that short selling was not a major element of his approach. Equally damaging was the admission by Chestnutt's vice president, thirteen months after Chestnutt had taken over the investment account, that Miller had not been given the information needed to understand the weaknesses and strengths of the Chestnutt organization, particu-

larly its weaknesses in other than "sustained bull markets". These frauds were accented by the portfolio manager's repeated assurances to Miller that the portfolio was ready for the "turnaround".

3. Chestnutt failed to observe the most elemental fiduciary responsibilities of a paid investment adviser. It emphasized in its soliciation materials the importance of the information and "facts" contained in its 'Percentage Strength Ratings' and then ignored these very ratings in the management of the Miller account which contained numerous securities assigned the lowest ratings, and it categorized the market trend evidence as "bullish" in complete disregard of the contrary trend of the stock market. Chestnutt had full knowledge of Miller's location in Africa and his reliance on the Chestnutt stock ratings and reports of market conditions.

4. The solicitation materials also described the desirability and indeed requirement to sell short and cut losses in weak securities. Nevertheless, Chestnutt continually held onto weak securities over long periods at substantial losses to the Miller account.

5. Miller was plainly deceived by the representations of Katcher in December of 1969, designed to keep the account with Chestnutt, that, despite losses, the account was in shape for the turn-around. The evidence of transactions in the account almost immediately thereafter showed clearly that Katcher's statement was knowingly false when made and operated as a deceit and a fraud upon the Millers.

6. Chestnutt's systems of graphs and tables and its Trend Oscillograph, lacking adequate disclosure of their limitations, were direct violations of the provisions of SEC Rule 206(4)-1(a)(3), as the Court of Appeals specifically held.

7. The *Medical Economics* article (A1-A7), reprinted and distributed to potential clients at Chestnutt's expense, was a "testimonial" to Chestnutt within the meaning of SEC Rule 206(4)-1(a)(1), the dissemination of which acted as a fraud and deception.

Based on the foregoing record, it is submitted that the jury had abundant evidence of Chestnutt's frauds against Mrs. Miller.

B. The Court of Appeals Examined the Entire Trial Record and Applied Settled Principles of Law.

The brief oral statement of the Second Circuit panel on appeal rejected Chestnutt's argument, now repeated in the Petition, about the adequacy of the charge to the jury.* The charge as a whole was considered "in the context of the entire record" and the Court of Appeals only commented on the District Judge's use of the word "negligently" disjunctively with the words "fraudulently" and "recklessly" as an element of common law fraud. The Court of Appeals held that this part of the charge did not require reversal for the reason that *scienter*, if required at all, is imputed where a negligent representation is made in the context of a violation of a duty of care. This holding was in full accord with the Connecticut law of fraud.

A delicate fiduciary relationship exists between investment adviser and client. *SEC* v. *Capital Gains Research Bureau, Inc.* 375 U.S. 180, 191 (1963); *Galfand* v. *Chestnutt Corp.* 545 F.2d 807, 811 (2d Cir. 1976) *cert. denied*, — U.S. —, 98 S.Ct. 1524 (1978). This relationship imposes a duty of reasonable care to avoid misleading clients. As stated in *SEC* v. *Capital Gains Research Bureau, Inc., supra:*

* Judge Van Graafeiland, in a concurring statement, correctly noted that petitioner had failed to meet the requirements of Rule 51, *Fed. R. Civ. P.* by not objecting to the charge. The holding of the Court of Appeals was on the assumption "for present purposes that objections to the charge were properly preserved in the district court . . ." (A25).

> Courts have imposed on a fiduciary . . . an affirmative obligation "to employ reasonable care to avoid misleading" his clients. There has also been a growing recognition by common-law courts that the doctrines of fraud and deceit which developed around transactions involving land and other tangible items of wealth are ill-suited to the sale of such intangibles as advice and securities, and that, accordingly, the doctrines must be adapted to the merchandise in issue. 375 U.S. at 194 [footnotes omitted].

Where the duty to disclose exists, the intentional nondisclosure of all the facts is actionable misrepresentation, *Franchey* v. *Hannes*, 152 Conn. 372, 207 A.2d 268 (1964), and the recipient of representations in a fiduciary context may be justified in relying on opinions on the basis that the maker has undertaken the investigation of the underlying facts. *Warman* v. *Delaney*, 148 Conn. 469, 172 A.2d 188 (1961); *Day* v. *Avery*, 548 F.2d 1018 (D.C. Cir. 1976) *cert. denied* 431 U.S. 908 (1977).

The Petition, in essence, asks this Court to make a third review of the trial record in the hope that it will conclude that the findings of a jury and four federal judges with regard to the weight and sufficiency of the evidence were wrong. Such further canvassing of the record would serve no interests outside those of the petitioner and is a task ill fit for the granting of a writ of certiorari.

POINT II

RESPONDENT HAS NOT RAISED A FIRST AMENDMENT ISSUE MERITING REVIEW

The Petition addresses an alleged issue of an impairment of First Amendment rights. Such a suggestion was raised for the first time tangentially in petitioner's reply brief before the Second Circuit. The claimed issue was not deemed to merit discussion below, and nothing in the Petition warrants this Court's review. It is noted that the Petition does not include a statement pursuant to the provisions of Supreme Court Rule 33(2)(b).

Commercial speech, while accorded limited protection under the First Amendment, *Virginia State Board of Pharmacy* v. *Virginia Citizens Consumer Council*, 425 U.S. 748 (1976), is nevertheless subject to regulation. In *Virginia Pharmacy* this Court stated: "The First Amendment...does not prohibit the State from insuring that the stream of commercial information flow cleanly as well as freely", *id.*, at 771-2; and found "no obstacle" to regulations of deceptive or misleading commercial speech, pointing specifically to the appropriateness of requirements of disclaimers or warnings to prevent deception. *Id.*, at 771 and n. 24.

Justice Stevens' opinion in *Young* v. *American Mini Theatres, Inc.*, 427 U.S. 50, 68 (1976) pointed out: ". . . regulatory commissions may prohibit businessmen from making statements which, though literally true, are potentially deceptive", citing *Jacob Siegel Co.* v. *FTC*, 327 U.S. 608 (1946) as evidence of long recognition of the Government's power to restrain misleading as well as false statements in labels and advertisements.

Most recently *Bates* v. *State Bar of Arizona*, 433 U.S. 350 (1977), stated:

> . . . [A]dvertising that is false, deceptive, or misleading of course is subject to restraint. (citation omitted). Since the advertiser knows his product and has a commercial interest in its dissemination, we have little worry that regulation to assure truthfulness will discourage protected speech....Indeed, the public and private benefits from commercial speech derive from confidence in its accuracy and reliability. Thus, the leeway for untruthful or

misleading expression that has been allowed in other contexts has little force in the commercial arena." *Id.*, 97 S.Ct. 2691, 2708-09.

First National Bank of Boston v. *Bellotti*, .__U.S.__, 98 S.Ct. 1407 (1978) cited by petitioner does not support its arguments. The question presented there was not whether corporations have First Amendment rights, but whether legislation prohibiting corporate expenditures made to influence an individual income tax referendum abridged the type of expression meant to be protected by the First Amendment. *Id.* 1415. *Bellotti* turned on the type of speech involved (described as "intimately related to the process of governing", *id.* 1421) and does not alter the conclusions quoted above regarding the propriety of regulating misleading or deceptive expression.

Petitioner would have this Court view the decision below as a direct infringement of the right to publish a "red book" or financial opinion. This case, however, does not affect the right to publish or express views; very simply, it involves the obligations of Chestnutt, having sought and induced reliance by means of such expression, to act in a way which is not misleading or deceitful.

Despite petitioner's protestations, this is a civil action for damages for fraud, not a case of indictment or attainder (*cf* Petition, pp. 4 and 11). The Court of Appeals correctly ignored petitioner's belated argument that the First Amendment insulates a paid investment adviser from its fiduciary responsibilities not to practice frauds and deceits upon clients.

POINT III

A PRIVATE RIGHT OF ACTION MAY PROPERLY BE IMPLIED TO REMEDY VIOLATIONS OF SECTION 206 OF THE INVESTMENT ADVISERS ACT OF 1940

Three courts of appeals in recently reported decisions have recognized a private right of action under Section 206 of the Investment Advisers Act.* There are no court of appeals decisions to the contrary, to respondent's knowledge. This Court has recently denied certiorari in *Abrahamson* v. *Fleschner* and petitions for a writ of certiorari are pending in *Wilson* and *Lewis* cited in the footnote.

In *Abrahamson*, Judge Timbers, writing for a majority of the Second Circuit panel, carefully elucidated the rationale for implying such a right of action and based the court's analysis on the controlling principles set forth by this Court in *Cort* v. *Ash*, 422 U.S. 66 (1975). A similarly careful analysis employing the *Cort* v. *Ash* criteria was carried out in the majority opinion of the Fifth Circuit in *Wilson*, and most recently, the Ninth Circuit in *Lewis* has expressly adopted these rationales.

These decisions are in full accord with the thrust of this Court's general recognition in *Cort* v. *Ash* and specific statement in *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 432 (1964) that private enforcement of federal rights are often a necessary supplement to effective federal regulation. The decisions of the three courts of appeals are the reasoned product of over a generation's experience with the federal securities laws and are

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* *Abrahamson* v. *Fleschner*, 568 F.2d 862 (2d Cir. 1977) *cert. denied*__U.S.__, 98 S.Ct. 2253 (1978); *Wilson* v. *First Houston Investment Corp.*, 566 F.2d 1235 (5th Cir.), *petition for cert. filed*, 47 U.S.L.W. 3019 (U.S. June 1, 1978) (No. 77-1717); *Lewis* v. *Transamerica Corp.*, 575 F.2d 237 (9th Cir.), *petition for cert. filed*, 47 U.S.L.W. 3019 (U.S. May 5, 1978) (No. 77-1645)

consistent with the decisions of this Court finding implied rights of action. The Petition fails to present compelling reasons for this Court to grant certiorari.

CONCLUSION

FOR THE FOREGOING REASONS, THE PETITION FOR A WRIT OF CERTIORARI SHOULD BE DENIED.

Dated: Stamford, Connecticut
October 20, 1978

Respectfully submitted,

Peter M. Ryan
10 Corbin Drive
Darien, Connecticut 06820

Samuel S. Cross
500 Summer Street
Stamford, Connecticut 06901

Of Counsel:

Cross, Brodrick & Chipman

IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-463

CHESTNUTT MANAGEMENT CORPORATION,
Petitioner,

v.

ELEANOR C. MILLER,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

PETITIONER'S REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

CLENDON H. LEE
Counsel for Petitioner
Chestnutt Management Corporation
One Dag Hammarskjold Plaza
New York, New York 10017
Tel. (212) 754-1430
(212) 940-8200

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Introduction

Respondent's brief in opposition usefully demonstrates the importance of granting the writ to determine how rapidly four quick judicial acorns may be permitted, if at all, to expand to a wildly mutant forest where Congress has provided no soil.

Respondent's thesis is that any speculative disappointment if labeled "securities law" may through judicial invention *dis*-invent free speech and due process.

I.

Petitioner Has Been Punished for Free Speech Opinion and Deprived of Due Process.

Respondent's brief in opposition demonstrates that this case is a Scopes Trial of stock market opinion resulting in automatic punitive damage, as well as the Sedition Law of financial writing.

Respondent's quotations (Resp. br. 4, 5) from the 17th Edition of the 1952 Redbook (Ex. 5) and references throughout demonstrate that the book was put on trial with an automatic presumption of punitive damage for a declining stock market.

Respondent's quotation (Resp. br. 5-6) from and references to the weekly opinion (Ex. 3):

> "With two exceptions, for thirty-six consecutive weeks from July 31, 1969 to April 9, 1970, the Survey began its commentary with these precise words: 'the general market trend evidence continues bullish.' Moreover, from June 26, 1969 through April, 1970, the Trend Oscillograph registered plus or 'bullish' and from January, 1970 showed extremely 'bullish' figures." (footnotes omitted)

demonstrate that opinion was put to the test of orthodoxy to be determined by the jury, failure of which test of orthodoxy resulted in automatic presumption of punitive damage for a declining stock market.

Respondent does not quote from (but merely refers to, at pp. 4, 12) the ten-column article published in *Medical Economics* (Ex. 4, reprinted A1-A7) written by Philip

Harsham as Senior Editor of that professional journal, since the mere fact of being ***written about*** was deemed to constitute violation of law resulting in automatic presumption of punitive damage for a declining stock market.* This is directly what the trial judge charged in his words (A12) that under the Investment Advisers Act of 1940 that it was illegal to employ any:

> ". . . device or scheme or artifice directly or indirectly to defraud a client. These words include the publication or circulation of any advertisement which directly or indirectly refers to a testimonial of any kind concerning the investment adviser or concerning any advice analysis or report or other service rendered by the investment adviser."

As shown (Pet., p. 13), Miller argued the same illegality of the published article to the jury.

These words of the charge, followed by the judge's words (A13) with respect to ". . . opinion relevant to the conditions of the securities market", (quoted more fully Pet., p. 14) demonstrate again that the only thing tried in this case was opinion, especially in the light of the fact that nowhere in this record or in the judge's charge is there to be found even a reference to any security, or any transaction, or any historical fact—whether material or immaterial—which was either misstated or omitted.

The monumental importance of this case to financial opinion free speech is illustrated by a full page copyrighted

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* To treat a third party's magazine article as "fraud" is only slightly less surprising than to suggest that the "D minus" rating by *Forbes Magazine* of a different advisory client (American Investors Fund, Inc.—Complaint ¶2, Pet., p. 6) is fraudulent *per se*, as if a concert artist should be punished according to a critic's grading scale.

advertisement (*Wall Street Journal,* Oct. 5, 1978, p. 9) of Merrill Lynch, not simply depicting the bullish "Thundering Herd", but stating in the middle column:

> "*Market expectations by institutional investors and the public are now at minimal levels.* Stock Market history suggests that opportunities are often more attractive when expectations are low. In this respect, the 'signals' are favorable." (Emphasis in original).

Toward the foot of the same column, after reference to severe "depreciation" of the U.S. dollar is the sentence:

> "This heightens the attractiveness of equities to foreign investors."

To borrow the words of Merrill Lynch, Chestnutt correctly found the " 'signals' to be favorable" in Spring 1970 immediately before the advance to all time highs in stock prices.

Readers of the Merrill Lynch advertisement were invited to obtain a publication which ". . . tells why we believe this may be a time of historic opportunity", which copyrighted publication* (replete with graphs) states (p. 7, col. 1):

> ". . . a period of rising stock prices appears likely if only because that is not what investors in general expect at this time."

Whatever the "expectations" of investors at that time, in a few days it was appropriate for another Dow-Jones publication to publish under its own name on the Cover Page (*Barrons,* October 30, 1978):

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* Merrill Lynch Pierce Fenner & Smith, Inc., "Common Stocks—A Perspective" (Fall, 1978).

"The October Massacre

Index	*Oct. 13*	*Oct. 27*	*% Change*
Amex	170.79	141.31	— 17.3
Barron's Low-Priced	440.50	a344.00	— 21.9
Dow Jones Industrials	897.09	806.04	— 10.2
Indicator Digest	51.69	43.71	— 15.4
NASDAQ Composite	135.58	115.25	— 15.0
Value Line Composite	116.06	a100.58	— 13.3"

a—Index as of 10/26/78

The "October Massacre" transpired simultaneously with a 21% increase in 3rd quarter profits of 548 corporations. (*Wall Street Journal,* Oct. 30, 1978, p. 1, Col. 6).

The prior (October 23, 1978) week's cover page of *Barron's* referred to its first article:

"The Chartist Pope

See page 4

Graph Omitted

Europe's leading technician is bullish on U.S. stocks. Adriaan Schrikker also likes the dollar. Bonds: 'a legalized swindle.' "

At page 4 of an extensive interview with Mr. Schrikker the first question and answer reads:

> "Barrons: How did you come by the nickname 'Chartist Pope'?
>
> A. I suppose because I've been pushing technical analysis so much in the last 15 years. When I first started here in Europe, most people laughed at me. Technical analysis as such comes from the other side of the big pond and was completely new in Europe."

The Chief Justice concluded the First Amendment ". . . belongs to all who exercise its freedoms". *First National Bank* v. *Bellotti*, —— U.S. ——, 98 Sup. Ct. 1407, 1429 (1978).

If Chestnutt can be punished for his opinion, what is the liability of Merrill Lynch after a $100 billion decline in two weeks? Who owes what to whom, and how much?

II.

Respondent Cannot Carve Out Any State Ground.

Irrespective of Illinois common law, the Court has reminded us in *Gertz* v. *Robert Welsh, Inc.*, 418 U.S. 323, 339 (1974):

> "We begin with the common ground. Under the First Amendment there is no such thing as a false idea."

This Court held in *New York Times Co.* v. *Sullivan*, 376 U.S. 254, 284 (1964):

> "The power to create presumptions is not a means of escape for constitutional restrictions."
>
> * * *
>
> "This is such a case, particularly since the question is one of alleged trespass across 'the line between speech unconditionally guaranteed and speech which may legitimately be regulated.' *Speiser* v. *Randall*, 357 U.S. 513, 525, 78 S.Ct. 1332, 1342, 2 L.Ed. 2d 1460. In cases where that line must be drawn, the rule is that we 'examine for ourselves the statements in issue and the circumstances under which they were made to see * * * whether they are of a character which the principles of the First Amendment, as adopted by the Due Process Clause of the Fourteenth Amendment, protect.' *Pennekamp* v. *Florida*, 328 U.S. 331, 335, 66 S.Ct. 1029, 1031, 90 L.Ed. 1295; see also, *One, Inc.* v. *Olesen*, 355 U.S. 371, 78 S.Ct. 364, 2 L.Ed.2d 352; *Sunshine Book Co.* v. *Summerfield*, 355 U.S. 372, 78 S.Ct. 365, 2 L.Ed.2d 352. We must 'make an independent examination of the whole record,' *Edwards* v. *South Carolina*, 372 U.S. 229, 235, 83 S.Ct. 680, 683, 9 L.Ed.2d 697, so as to assure ourselves that the judgment does not constitute a forbidden intrusion on the field of free expression."

Irrespective of Tripoli,* claimed Vermont citizenship by the California and New York international lawyer, or any other state "contacts", there was no contention that Connecticut did not follow the universal common law principle already expressed in a suit under the Advisers Act as to pendent common law by Judge Levet in *Jones Memorial Trust* v. *Tsai Investment Services*, 367 F.Supp. 491 (1973), upon which Chestnutt's proposed charges (A8-A10) were expressly based. Judge Levet decided (367 F.Supp. at 499) in the Southern District of New York:

> "In order for a prediction or promise to satisfy the requirement of misrepresentation of a material fact said prediction or promise must have been made with an intent not to comply therewith. *Sabo* v. *Delman*, 3 N.Y. 2d 155, 159-160 (1957). The contention that plaintiff has proved such intent is unsupported. No credible evidence indicates that defendant had the required intent."

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* Respondent Miller's receipt within 5 to 8 days of Chestnutt's current opinion renders ludicrous the pervasive syndrome in respondent's brief of Darkest Africa/Dr. Livingstone.

In the *Sabo* case, Judge Fuld had stated the universal common law rule (3 N.Y.2d at 159-160):

> "While 'Mere promissory statements as to what will be done in the future are not actionable' (*Adams* v. *Clark,* 239 N.Y. 403, 410, 146 N.E. 642, 644), it is settled that, if a promise was actually made with a preconceived and undisclosed intention of not performing it, it constitutes a misrepresentation of 'a material existing fact' upon which an action for rescission may be predicated."

The "forbidden intrusion on the field of free expression" (*N.Y. Times, supra*) is quite evident, since neither respondent nor either court below ever identified any security or any transaction claimed to be fraudulent, nor pointed to any alleged misstatement or omission of any historical fact.*

Only a specific fraudulent transaction, alleged and proved with the "particularity" required by Rule 9(b), Fed.R. Civ.Pr., could amount to a "substantive evil" such as "fighting words" or "shouting fire" in a crowded theatre.

Here, the sole *corpus delicti* is published opinion itself, never heretofore a "substantive evil".

* Since Chestnutt did not peddle real estate or sell anything to, or buy anything from respondent, it is understandable that respondent does not adopt Judge Timber's invocation (A25) of Pennsylvania backed up sewage (*Shore* v. *Hoffman,* 227 Pa.Super. 176, 324 A.2d 532 (1974)), District of Columbia real property surveys (*Isen* v. *Calvert Corp.,* 379 F.2d 126 (C.A.D.C., 1967)), title to whiskey in Salt Lake City (*Stein* v. *Treger,* 182 F.2d 696 (C.A.D.C., 1950)) or defense on a note for purchase of Kentucky bank stock (*Anderson* v. *Tway,* 143 F.2d 95 (6 Cir. 1944)).

III.

This Court Should Now Determine Whether the Advisers Act Provides for Money Damage.

Respondent's brief (p. 17) relies upon three divided circuits as to "implication".

Several months after the trial judge's charge herein (October 5, 1975), Mr. Justice Blackmun, dissenting, in *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976) regretted failure of the Court to go "beyond common law fraud" (at 217).

As pointed out in our petition (p. 15), the SEC has never through "available sanctions" or prospective equitable relief sought further disclosures in the Redbook or the weekly service. This Court listed seven separate securities by name, the *prices* of which might have been affected by the timing of transactions and recommendations, when the Court approved compelling future disclosure of the practice. *SEC* v. *Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 202 (1963).

Now, after 38 years, this present case after final money judgment is the fourth petition* to confront the Court in the few months since *Abrahamson* v. *Fleschner,* (2 Cir., 1977) 568 F.2d 862.

Further, since contrary to *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975) which barred suits for alleged "fraudulent" inducement not to buy or sell, this case

* *Fleschner* v. *Abrahamson* (No. 77-1279), *cert. den.* May 15, 1978, two Justices noting their views that the writ should be granted.
Transamerica Mtg. Advisers v. *Lewis* (No. 77-1645).
First Houston Investment Corp. v. *Wilson* (No. 77-1717).

alleged and went to the jury (Pet., p. 7) for "recklessly" failing to make "short sales".

Our petition (p. 7) plagiarizes the reasons for granting the writ in *Fleschner* (No. 77-1279). Further, this case would appear to be a compelling one for the exercise of this Court's supervisory jurisdiction as to statutory construction.

CONCLUSION

For the reasons stated and incorporated in the Petition a writ of certiorari should issue to the United States Court of Appeals for the Second Circuit.

Respectfully submitted,

CLENDON H. LEE
Counsel for Petitioner
Chestnutt Management Corporation
One Dag Hammarskjold Plaza
New York, New York 10017
Tel. (212) 754-1430
(212) 940-8200

November 2, 1978

IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-463

CHESTNUTT MANAGEMENT CORPORATION,
Petitioner,

vs.

ELEANOR C. MILLER,
Respondent.

MOTION OF INVESTMENT COUNSEL ASSOCIATION OF AMERICA, INC. FOR LEAVE TO FILE A BRIEF AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI, AND BRIEF IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI.

JOHN L. CASEY
Member, Board of Governors,
Investment Counsel Association
of America, Inc.,
Suite 2600,
345 Park Avenue,
New York, New York 10022,

PAUL J. MILLER,
SONNENSCHEIN CARLIN NATH
& ROSENTHAL,
8000 Sears Tower,
Chicago, Illinois 60606,
Counsel for Investment Counsel Association of America, Inc.

Gunthorp-Warren Printing Company, Chicago • Financial 6-6565

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Respondent.

MOTION OF INVESTMENT COUNSEL ASSOCIATION OF AMERICA, INC. FOR LEAVE TO FILE A BRIEF AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI.

Pursuant to Rule 42 of the Rules of the Supreme Court of the United States, the Investment Counsel Association of America, Inc. ("ICAA") hereby moves for leave to file a brief as *amicus curiae* in support of the petition for writ of certiorari filed by petitioner, Chestnutt Management Corporation. Counsel for respondent Eleanor C. Miller has no objection, but has not been able to obtain the consent of Eleanor C. Miller.

The ICAA was organized in 1937 as an association of those investment advisers engaged in rendering investment counsel

services to clients. The member firms constitute virtually all of the larger and many of the smaller firms registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940 ("Act") who are independent of the banking and brokerage industries and render continuous portfolio supervision and advice to clients on the basis of their individual needs and circumstances.

The ICAA has no interest in the essentially private aspects of the dispute. Petitioner is not a member of the ICAA. ICAA's concern is with the creation of a new, undefined private right of action against investment advisers. The ICAA was an important participant in the hearings and negotiations that culminated in the industry draft that became the Act. It therefore feels that it is uniquely qualified to assist the Court in its review of the Act's legislative history.

The United States Court of Appeals for the Second Circuit recognized the "importance and novelty"[1] of its decision to imply a private right of action under the Act. That decision, arrived at over a vigorous dissent, is now applied automatically in this case. It affects an industry which the Securities and Exchange Commission recognizes has "substantial impact . . . on both the economy and the public investor. . . ."[2] The ICAA believes that the decision is premised on an misreading of the Act's legislative history.

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1. *Abrahamson* v. *Fleschner*, 568 F. 2d 862 (2nd Cir. 1977).

2. Statement of the Securities and Exchange Commission in Support of Proposed Amendments to the Investment Advisers Act of 1940, transmitted to Congress by Chairman Hills in December, 1975. (Legislation to Amend Investment Advisers Act of 1940 Proposed by the Securities and Exchange Commission, Investment Advisers Act Release No. 491 (December 15, 1975), [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,341).

The ICAA therefore respectfully prays that the Court grant this motion for leave to file its brief in support of the petition for writ of certiorari.

Respectfully submitted,

JOHN L. CASEY,
Member, Board of Governors,
Investment Counsel Association
of America, Inc.,
Suite 2600,
345 Park Avenue,
New York, New York 10022,

PAUL J. MILLER,
SONNENSCHEIN CARLIN NATH
& ROSENTHAL,
8000 Sears Tower,
Chicago, Illinois 60606,
Counsel for Investment Counsel Association of America, Inc.

November 2, 1978.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1978.

No. 78-463.

CHESTNUTT MANAGEMENT CORPORATION,
Petitioner,

vs.

ELEANOR C. MILLER,
Respondent.

BRIEF OF INVESTMENT COUNSEL ASSOCIATION OF AMERICA, INC., AMICUS CURIAE, IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI.

This brief is submitted on behalf of the Investment Counsel Association of America, Inc. ("ICAA") as *amicus curiae* in support of the petition for writ of certiorari of Chestnutt Management Corporation.

The ICAA was organized in 1937 as an association of those investment advisers engaged in rendering investment counsel services to clients. The member firms of the ICAA constitute virtually all of the larger and many of the smaller firms registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940 ("Act") who are independent of the banking and brokerage industries and render continuous portfolio supervision and advice to clients on the basis of their individual needs and circumstances. Petitioner is not a member of the ICAA.

The ICAA has no interest in the essentially private aspects of the dispute. Petitioner is not a member of the ICAA. Its concern is with the creation of a new, undefined private right of action against investment advisers. The ICAA was an important participant in the hearings and negotiations that culminated in the industry draft that became the Act. It therefore feels that it is uniquely qualified to assist the Court in its review of the Act's legislative history.

ARGUMENT.

When the Act became law in 1940, it made no provision for a private right of action. There was no statement in the legislative history indicating that Congress even considered the question of a private action.[1] The Act was viewed as fundamentally "a compulsory census."[2] Section 214 of the Act granted jurisdiction to the district courts to hear criminal prosecutions and "suits in equity to enjoin any violation of this subchapter"; it made no provision for "actions at law." Twenty years later, Congress amended the Act extensively, strengthening the SEC's enforcement powers.[3] No change to § 214 was proposed[4] and no change was made. In 1970 the Act was amended again; its companion statute, the Investment Company Act, was also amended. While a carefully delimited express right of action against an investment adviser to a mutual fund was added to the Investment Company Act,[5] no provision for jurisdiction over "actions

1. *Abrahamson* v. *Fleschner*, 568 F. 2d 862 (2nd Cir. 1977).

2. *Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency, 76th Cong., 3d Sess. (1940)* [*hereinafter "Senate Hearings"*] *at 48.*

3. The following sections of the Act were amended in 1960: 202(a)(12), 202(a)(18), 203(c)(1)(f), 203(c)(2), 203(d), 210(b), 211(a), and 217. Three sections or subsections were added: 206(4), 208(d) and 222.

4. The SEC made "extensive proposals." S. Rep. No. 1760, 86th Cong. 2d Sess. 2 (1960).

5. Section 36(b), Investment Company Act.

at law" was added to the Act. Finally, in 1975 the SEC proposed that § 214 be amended to add "actions at law brought to enforce any liability or duty created by [the Act]"[6] and hearings were held on that proposal.[7] However, no change was made.

Thus, in contrast to all of the other federal securities acts,[8] the Act has never provided for jurisdiction over "actions at law." At no time has Congress evidenced any intent that the Act should form the basis for such an action.

The history of the birth of the Act is equally compelling. Early drafts contained, either directly or by reference, language regarding "actions at law."[9] These were opposed by the industry[10] and negotiations between the industry and the SEC ensued.[11] The ICAA played an important role in those negotiations and in the drafting that followed. The result was an industry draft that had deleted any references to jurisdiction

6. Investment Advisers Act Release No. 491 (December 15, 1975), [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,341.

7. *Investment Advisers Act Amendments: Hearings on S. 2849 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs, 94th Cong., 2d Sess. (1976); Investment Advisers Act Amendments: Hearings on H. R. 13737 Before the Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce, 94th Cong., 2d Sess. (1976).*

8. Securities Act of 1933, Section 22, 15 U. S. C. § 77v; Securities Exchange Act of 1934, Section 27, 15 U. S. C. § 78aa; Public Utility Holding Company Act of 1935, Section 25, U. S. C. § 79y; Trust Indenture Act of 1939, Section 322, 15 U. S. C. § 77vvv; and Investment Company Act of 1940, Section 44, 15 U. S. C. § 80a-43.

9. See, *e.g.*, S. 3580, 76th Cong., 3d Sess, 98 (introduced by Sen. Wagner on March 14, 1940); H. R. 8935, 76th Cong., 3d Sess. 98 (introduced by Cong. Lea on March 14, 1940).

10. *Investment Trusts and Investment Companies: Hearings on H. R. 10065 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce, 76th Cong., 3d Sess. (1940)* [*hereinafter "House Hearings"*] *at 88-90, 92; Senate Hearings at 712-723, 737-54.*

11. *House Hearings* at 88-90, 92; S. Rep. No. 1775, 76th Cong., 3d Sess. 21 (1940).

over "actions at law" or to "liability". With those deletions the draft became the Act:

> "In connection with the investment advisers, I think that Robert Page who represented Scudder, Stevens & Clark . . . submitted a draft of the bill to us, which is the draft that is included in this new bill."[12]

In short, the history of the Act—both in its birth and development—demonstrates that Congress never intended to create a private right of action under the Act.

The Act reflects a deliberate Congressional balance of the interests of the investment advisory industry and the interests of its clients.[13] That balance is destroyed in the Second Circuit's opinion that must,[14] but cannot, find support in the Act's legislative history. In its place, the Second Circuit would create a "claim for relief without limitation", an undefined cause of action that the federal courts will have to fashion through countless lawsuits. This should not be permitted. *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U. S. 723 (1975).

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12. *Senate Hearings* at 1124.

13. S. Rep. No. 1775, 76th Cong., 3d Sess. 20-21 (1940) (Remarks of Rep. Wolverton).

14. *Ernst & Ernst* v. *Hochfelder,* 425 U. S. 185, rehearing denied 425 U. S. 986 (1976).

CONCLUSION.

For the foregoing reasons, the petition for writ of certiorari by Chestnutt Management Corporation should be granted.

Respectfully submitted,

John L. Casey,
Member, Board of Governors,
Investment Counsel Association
of America, Inc.,
Suite 2600,
345 Park Avenue,
New York, New York 10022,

Paul J. Miller,
Sonnenschein Carlin Nath
& Rosenthal,
8000 Sears Tower,
Chicago, Illinois 60606,
Counsel for Investment Counsel Association of America, Inc.